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CHARTERED
ACCOUNTANT



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Summary of Royal Commission on Taxation

Valuation of Private Company Shares

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THE CANADIAN BAR REVIEW,
June-July 1955

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THE CANADIAN CHARTERED ACCOUNTANT

VOL. 68, NO. 1, JANUARY 1956

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Opinions expressed are not necessarily endorsed by The Canadian Institute of Chartered Accountants

Published Monthly by

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS
69 Bloor Street East, Toronto

Chairman, Magazine and Publications Committee: J. J. MACDONELL, C.A.

Editor: RENNY ENGLEBERT

Assistant Editor: JEAN VALE

Advertising Representative: E. L. VETTER

*The editor invites members and others to submit articles for publication.
Manuscripts should be typewritten and double-spaced.*

Subscription Rate \$5.00 per Year; Single Copies: Current and five immediately
preceding volumes - 50c; earlier volumes - \$1.00

Printed by General Printers Limited and mailed at Oshawa, Ontario
Authorized as second class mail by the Post Office Department, Ottawa

IN THIS ISSUE

J. HARVEY PERRY

Since its publication last June, accounting journals everywhere have published reports on the Royal Commission on the Taxation of Profits and Income — a Government Bluebook, close to 500 pages in length, which from first to last has occupied several years of searching study of the law in relation to taxation.

We are presenting in this issue a summary of its more important recommendations and plan to reproduce fully in the next issue Chapter 18 of the report, which discusses inventory valuation and its role in the computation of profits.

While Harvey Perry points out that so lengthy a report cannot be summarized adequately in such a brief article, we feel that nobody is more competent to deal with the subject. Mr. Perry is well known to business men as the director of The Canadian Tax Foundation. He was formerly director of research for the Foundation and before that was for 16 years with the Federal Department of Finance. He is a frequent contributor to tax and other periodicals and has written a number of books, including "Taxation in Canada" and "Taxes, Tariffs and Subsidies", a history of Canadian fiscal development. In 1953 he completed a special assignment for the Colonial Office in Nigeria, West Africa.

HAROLD E. CRATE, F.C.A.

We think that estate lawyers will be as attracted to Harold E. Crate's article "The Valuation of Shares of

Private Companies" as members of the accountancy profession. The need for approved valuation of shares can arise either before or after the death of the shareholder. As the objective is to minimize death duties, it is obvious that pre-planning of the estate is an important step, but it should be borne in mind that the problem of valuation arises in all estates which include such shares.

Mr. Crate is a partner of Thorne, Mulholland, Howson & McPherson, having been in public practice with his present firm for 30 years. He is a past president of the Institute of Chartered Accountants of Ontario and became a Fellow of the Institute in 1947. He has had special experience in taxation matters and is a firm believer in preventive planning. Mr. Crate is presently a Governor of The Canadian Tax Foundation and serves on the Canadian Institute's Committee on Taxation.

C. L. MITCHELL, C.A.

With the increased interest in the entire field of annual reporting has come an increased interest in the techniques which go towards making the report the most important single document issued by a corporation in any fiscal year. One of these is the president's letter almost invariably submitted "on behalf of the Board" and which appears near the front of nearly every annual report.

In his article "Management's Report to Shareholders", C. L. Mitchell indicates some of the topics to be covered in this part of the report and suggests that, in many instances, stockholders are not being given properly presented information to which they are entitled through the "president's letter" or "report to shareholders".

Continued on page 6

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many
agree
on



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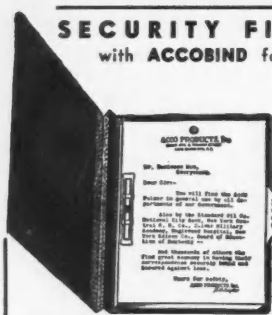
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Continued from page 4

Mr. Mitchell was formerly with Peat, Marwick, Mitchell & Company and is a member of the Institute of Chartered Accountants of Ontario and British Columbia. He is currently chairman of the Education Committee, Institute of Internal Auditors and an Assistant Professor at the School of Commerce, University of British Columbia.

EDITORIAL

As we all recognize, students have varying backgrounds of education and experience and varying degrees of ability. Nevertheless, they may benefit from the advice given in this month's editorial by Gordon Ferguson, who suggests that "it might be more advisable for those who fail or barely pass their examinations to reconsider their choice of a vocation rather than maintain mediocrity in the field of accounting". Mr. Ferguson bases his advice on years of experience and examination work. He has served respectively on the Ontario Institute's Examination Committee and is its representative to the Board of Examiners-in-Chief. He currently holds the position of chairman of that Board. Mr. Ferguson is a partner in the firm of Thorne, Mulholland, Howson & McPherson and became a Fellow of the Ontario Institute in 1953.

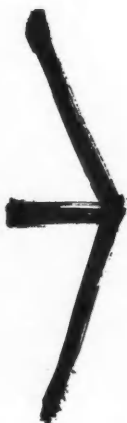
FORTHCOMING FEATURES TWENTY YEARS OF CANADIAN WHEAT BOARD OPERATIONS

by Gordon Earl, C.A.
THE CASE FOR SOCIAL
ACCOUNTING

by J. E. Smyth, C.A.
HAVE THE RAILWAYS HAD THEIR
DAY?

by J. A. McDonald
RECOMMENDATIONS ON INVENTORY
VALUATION

from U.K. Royal Commission
Report



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NOTES AND COMMENTS

C.I.C.A. Examination Results

The number of chartered accountants in Canada will increase shortly by approximately 450 to bring the



JOHN E. SANDS
Gold Medal

profession in sight of 7,000 members. The Canadian Institute of Chartered Accountants announced recently that out of 887 final candidates 450 passed and another 133 obtained "partial pass" standing in C.A. examination results across Canada.

WILLIAM A. BRADSHAW
Silver Medal



A total of 1,679 students wrote the exams. Of 792 intermediate candidates 477 passed and will normally have two years to go before their finals. All three prizewinners come from the Province of Ontario.

The Governor-General's gold medal, which also carries with it a cash award and an all-expense trip to the C.I.C.A.'s annual meeting (in Halifax next September), was won by John E. Sands, Toronto, Ont. He was born in Toronto and educated at North Toronto Collegiate and University of Toronto, where he gradu-

ated with a B.Com. degree. He is at present working in the Toronto office of George A. Touche & Co.

DAVID W. LAY
Silver Medal



William A. Bradshaw, 27, of Toronto was the C.I.C.A. silver medalist. He was educated at Upper Canada College and is a B.A. graduate of the University of British Columbia. He has been working since 1951 with Thorne, Mulholland, Howson & McPherson, Toronto.

The Governor-General's Medal is awarded for the highest average standing on the six final papers. The silver medal goes to the senior candidate with the second highest marks.

Top marks in the intermediate exams — and the C.I.C.A.'s silver medal for this achievement — were awarded to David W. Lay, 22, now training with Clarkson, Gordon & Co., Hamilton.

Highland Hearts

With the publication of the 1955 official directory of the Institute of Chartered Accountants of Scotland, it is noteworthy that the number of members of that Institute resident in Canada has increased by more than 50% in the past four years — from 121 to 189.

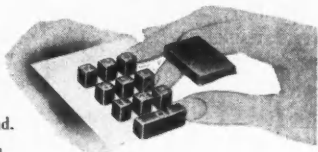
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A Half Century of Service

With the appearance of its November 1955 issue, *The Journal of Accountancy*, official organ of The American Institute of Accountants, celebrated its 50th anniversary as an accounting publication. The task which it set for itself in November 1905 was "to speak regularly, wisely and consistently" in the name of the profession, and through the years it has fulfilled this with both loyalty and integrity.

Its special 50th anniversary issue glances backward very briefly over the salient events of the Journal's past, but devotes the larger part of its space to eight feature articles on how the accountant must cope with the problems of today and tomorrow. Written by authorities whose names are familiar to anyone who has ever frequented an accounting library, these articles discuss ethics, education for the profession, management services, taxes, as well as current issues in accounting and auditing practices.

With becoming modesty the Journal acknowledges in 1955, as it did in 1905, its dependence on members of the profession if it is to continue its mission. That the profession acknowledges reciprocal dependence on it is amply evidenced by the increase in its circulation figures — from a few hundred when it commenced publication to 86,000 today.

Railway Accounting Revised

Several years work by the Board of Transport Commissioners, assisted by financial experts from the two major railways, has resulted in a new uniform system of accounting for Canadian railways which goes into effect January 1, 1956.

The new system, which Parliament

ordered instituted in 1952, will be under the watchful eyes of a new accounts and cost-finding bureau of the Board. By this means the Board expects to have a closer check on the operations of the railways and eventually hopes to simplify the involved questions of railway revenues on which it has hitherto had to spend a great deal of time.

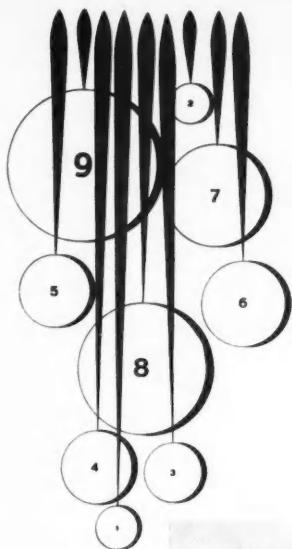
Annual Report Winners

The awards of the fifth annual report contest sponsored by *The Financial Post* were announced recently. Winners of the Manufacturing and Processing — Metals and Metal Products section were Aluminium Ltd., Massey-Harris-Ferguson Ltd. and Ford Motor Co. of Canada, while in all other groups of Manufacturing and Processing the winners were Abitibi Power & Paper Co., Bathurst Power & Paper Co. and Imperial Oil Ltd. In Retailing and Distributing top awards went to Dominion Stores Ltd., Henry Morgan & Co., and Silverwood Dairies Ltd. For the Mining and Oil Production category Falconbridge Nickel Mines Ltd., Royalite Oil Co. and Asbestos Corp. were chosen. Industrial Acceptance Corp., Canada Life Assurance Co. and Union Acceptance Corp. were the best of Financial Institutions, and Union Gas Co. of Canada, B.C. Power Corp. and Shawinigan Water & Power Co. the best of the Public Utilities group.

In the News

F. T. MACE, C.A. has recently been appointed Assistant Deputy Minister of Veterans Affairs.

Named general campaign chairman for Montreal's 1956 Red Feather drive is JOHN R. CHURCH, F.C.A., a partner of Price Waterhouse & Co.



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LETTERS TO THE EDITOR

Kitchener, Ont., Nov. 15, 1955.

RE: STUDENTS-IN-ACCOUNTS

Sir: The problem of obtaining students-in-accounts is increasing and at the moment there does not seem to be any practical solution.

I understand there has been a suggestion made that high school students who have failed their final examinations in one or two subjects be admitted as students-in-accounts, on condition that those subjects be written off before the student can try his primary examinations.

I do not think that this is the answer to the problem for the following reasons:

1. It is a lowering of our educational standards and runs counter to university standards.

2. It increases the difficulty of a student passing his primary examinations inasmuch as his time is divided between his academic studies and the chartered accountant's course.

3. Only about 10% to 15% of the high school students fail in their final examinations with the result that this suggested action would mean that we are trying to make up our deficiency from only 10% or 15% of the entire student body. It would seem much wiser to concentrate our efforts on the 85% to 90% of the students who have passed their examinations

In interviewing high school students who are considering entering the profession, I have found that the main problem in the student's mind is whether he should go to university or enter employment with a firm of chartered accountants.

Most of the students want to attend uni-

versity and in view of the trend to a more liberal education, this leaning should be encouraged.

In the circumstances, it would appear that the solution to our student problem is to find ways and means of encouraging graduates, particularly those graduating in Arts, to enter the profession.

Again, in talking to high school graduates who can and want to attend university but who would also like to become chartered accountants, I have noticed an almost invariable reaction that the total length of time (eight years in the case of an Arts graduate) is too long.

A graduate in Arts should be able to take the five year course in accountancy in three years. His university training as a student should make it possible for him to grasp the fundamentals in accountancy much quicker than a high school graduate.

In addition, the greater number of college graduates serving as students-in-accounts should strengthen the profession inasmuch as our juniors would be three or four years older than those coming directly from the high schools.

Therefore, it is suggested that our regulations be revised to permit graduates in Arts to take the examinations in three years. If this were done, it might be possible to arrange that such Arts graduates be required to take certain stipulated subjects during their college term.

C. H. MITCHELL, C.A.

Editor's Note: This letter has been written to stimulate discussion. Readers are invited to forward any criticisms or suggestions in connection with it.

THE CANADIAN CHARTERED ACCOUNTANT

Article Writing Competition

THE CANADIAN CHARTERED ACCOUNTANT announces that it will sponsor an Article Writing Competition for students and chartered accountants who have obtained their certificates since January 1, 1945. Contestants may write on any subject of their choice relevant to the field of accounting, auditing or taxation.

Articles may be written in English or French.

• • • • •

Prizes: First prize \$300; second prize \$200; third prize \$100.

Closing date: Midnight on February 29, 1956.

Eligibility: The contest will be open to:

- (1) A student in accounts of any provincial Institute in Canada or a candidate for the Diploma of Licentiate in Accountancy of one of the 3 recognized Quebec Universities who is presently employed by a practising chartered accountant in Canada.
- (2) A member in good standing of the C.I.C.A. who initially obtained his certificate of admission to a Provincial Institute in Canada or to a recognized overseas Institute since January 1st, 1945 (except members of the staff of the Canadian Institute of Chartered Accountants).

Note: Anyone intending to enter the contest should communicate with the Executive Secretary, The Canadian Institute of Chartered Accountants, 69 Bloor Street East, Toronto, who will furnish the official announcement and a memorandum of additional instructions.



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sion of productive facilities, greater output, and increased activity in searching for and developing new ore bodies in many parts of Canada.

Because Canadian base metals are becoming more and more essential in meeting world requirements and in Canada's expanding economy, you may think it desirable to include in your list of investments the securities of at least some of the important companies in this industry. If so, you might like to discuss with us an investment in Canadian base metals. Just write or visit any of our offices.

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Editorial

AN EVALUATION OF EXAMINATIONS

EXAMINATIONS ARE often criticized as being ineffective attempts to classify a group of students according to their relative ability. In fact many people condone their continued use only on the grounds that a more realistic means of testing a student's knowledge has not yet been devised. So far as our own members are concerned, the widely varying opinions in regard to examinations and results are, at least in part, due to the conflict between the demand for qualified men from the profession and industry, and the recognized need for maintaining a minimum standard.

The general consensus is that the standards imposed are not too high. From the members' viewpoint, examinations are intended to ensure that the standards of the profession are maintained, so that the use of the designation "C.A." will make the public conscious of a standard of service which will merit confidence and respect. On the other hand, the student's attitude towards examinations often shows a lack of perspective and maturity. Too often, the final examination is considered as the last stumbling block or hurdle which must be overcome to gain access to a lucrative professional practice or to obtain a top position in industry.

It should not be forgotten that success in the final examination is merely an acknowledgment that the student seems qualified to advance toward further study and endeavour. In other words, his future success does not depend on a comprehensive knowledge of the subject matter covered during his training and in the examinations. It rests, rather, on the judgment, wisdom, astuteness and industry of the individual in applying the basic knowledge covered in the course and in the wealth of experience and further knowledge which must be acquired after getting his certificate.

Failure to pass the examinations of today is fairly conclusive evidence that the necessary attributes are lacking and it is doubtful whether those in this category can apply themselves to face the more intricate problems and heavy responsibility of professional practice. It might be more advisable for those who fail, as well as those

who barely pass, to reconsider their choice of a vocation and try to achieve success in a job for which they are suited, rather than maintain mediocrity in the field of accounting.

Statistical analyses of candidates and examination results, while not entirely conclusive, indicate that students who should pass the final examinations are successful and this is also confirmed by members of the profession who have something to do with individual cases. Hundreds of man hours go into the preparation of examinations, which includes the preparation of basic solutions, the extensive test marking and selection of alternative solutions before actual marking begins and the supervision and test checks that are employed during marking. All these features eliminate any significant weaknesses usually attributable to a system of examinations and arrive at a desired grouping of candidates. The first group consists of those considered to be above the passing standard and a small number who have attained the highest standing. The second group comprises those below the passing standard and a sub-group considered to be just below the passing standard.

The subsequent review of the papers as a whole in each subject for students just below the passing standard is undertaken to ensure that the marking basis consistently employed has not prejudiced these students in comparison with those who have passed. A review of the papers of students who have attained the highest standing within the passing standard is also made to ensure that the marks allotted classify the candidates in order of merit for award purposes. On this basis, our examination procedures may be considered satisfactory and effective and, from the students' point of view, eminently fair.

Our profession, however, is far from static; it is becoming constantly more complex and the responsibilities more exacting and onerous. To maintain a rising standard in line with the need for ever increasing ability will result in a lower percentage of successful candidates. Where should the corrective measures be imposed? Should we follow the trend of requiring a specialized university education to qualify for admission? This has the effect of pre-screening the candidates and results in their entering the course better qualified and more mature. Should we adopt annual examinations and screen students at a lower level to the mutual advantage of the students themselves and the profession? Can the profession compete with industry, financially and otherwise, for the better type of student? Questions such as these must always be in the foreground of our thoughts if the profession is to maintain its position in this ever changing world.

Management's Report to Shareholders

C. L. MITCHELL

ANYONE TAKING time to study the directors' letters which appear in the annual reports of Canadian corporations will observe some interesting contrasts in length, composition and presentation. Some, for instance, contain a few short paragraphs and present one or two topics only; others range upwards of 15 pages and attempt to discuss virtually every phase of their companies' operations. There are some that are interesting and easy to follow and others that require slow, methodical reading if they are to be understood. What, then, is the extent of the variation between different directors' letters and what constitutes a good director's report?

For the purpose of this article, the term "director's letter" will be used to indicate the written report which appears near the front of almost every annual report. It may be called the "president's letter" or "report to shareholders" but it is almost invariably submitted "on behalf of the board".

The Significance and Function of Directors' Letter

The widespread separation of ownership and management in our modern complex business society

necessitates an adequate channel of communication from managers to owners to report on the progress of the business enterprise. In theory, this takes place at the annual meeting, which is required by law but which, however, many shareholders are unable to attend. In actuality it is the annual report which is today the most important medium of communication to shareholders. Management is now faced with the problem of having to report to shareholders by means of the annual report. Yet at the same time it fully realizes that most shareholders can extract little meaning from the "heart" of the report, i.e. the financial statements. This point was well illustrated a few years ago by Don Knowlton who said: "As far as Joe Doakes is concerned, and for that matter the majority of employees and stockholders and the general public, they (financial statements) might as well be printed in Latin or Greek."¹

Nonetheless, the shareholders must receive full and proper information regarding the company's opera-

¹ Don Knowlton, "The Semantics of Annual Reports", *The Canadian Chartered Accountant*, Vol. 42, (February, 1948), p. 79,

tions and it is the responsibility of professional management to provide it. Where, then, are they going to get it in a form they can properly comprehend? The answer is in the directors' letter. The directors should interpret, in the letter which is submitted on their behalf, the detailed results of the company's operations (as presented in the financial statements) in a fair and comprehensive manner which is readily understandable to all the shareholders.

Since the letter is usually signed "on behalf of the board", the statements advanced will be accepted without question; they will be deemed to carry the "stamp of approval" of the directors. This fact should alone inspire a feeling of responsibility on the part of those preparing the letter.

The shareholders are the principal recipients of annual reports and the directors' letter often addressed to them, should be primarily concerned with their interests. However, the letter will actually be read by three main groups:

1. Shareholders
2. Prospective investors and analysts
3. Employees.

It would do no harm for the directors to bear in mind also the interests of the other two groups in formulating their letter. A good directors' letter is bound to leave a favourable impression in the mind of any reader.

It has been said that an annual report can be a tombstone or an evidence of life.² This is equally true of

directors' letters. All directors should endeavour to present to shareholders a letter which indicates strong signs of life and evidences that the shareholders' interests are being properly protected.

A Study

A recent study has been made of a number of directors' letters. The sample for this was chosen at random from a file of annual reports maintained in the School of Commerce of the University of British Columbia. Every tenth report in the file was picked out and incorporated, resulting in a total of 46 annual reports which represented all major corporations with the exception of mining and oil exploration.

First, a preliminary survey was made of current directors' letters of ten large Canadian companies in order to ascertain topics that could be expected to appear. These topics, 18 in total, were then used as a basis for analyzing the sample — by topics, by companies, by quality of presentation. Notes on the layout and organization of the letters were also made.

The analysis by companies indicated that, on the average, a directors' letter mentioned only eight out of a possible 18 topics. However, the number varied by individual companies, some presenting as many as 14, others as few as three. Slightly over one half of the letters discussed between seven and ten topics.

Topics

The quality of presentation of topics varied considerably between companies, and between topics within the same letter. In 9% of the cases the topic was treated in an outstanding and exceptionally clear concise manner; 59% gave clear and concise pre-

² Robert O. Baker, "Your Annual Report — Tombstone or Evidence of Life", *The Controller*, Vol. 20, (February, 1952), p. 70.

sentation; 9% were discussed too extensively; 23% were dealt with in too brief a fashion to be considered adequate. Five topics — employee tribute, officers and directors, bonds and capital stock, affiliated companies, and dividends — were well presented in 80% of the cases where reference was made to them. Three topics — sales, outlook for company, and surplus — failed to meet an adequate level of presentation 50% of the time.

A detailed list of topics and frequency of presentation is given below:

Topic	No. times mentioned (max. 46)	% times mentioned
1. Earnings	44	96
2. Employee tribute	37	80
3. Fixed assets	35	76
4. Dividends	33	72
5. Sales	28	61
6. Working capital	27	59
7. Outlook for company	27	59
8. Taxes	21	46
9. Bonds and capital stock	20	43
10. Offices and directors	19	41
11. Surplus	17	37
12. Affiliated companies	14	30
13. Depreciation	12	26
14. Personnel relations	10	22
15. Canadian economy	8	17
16. Inventories	7	15
17. Reserves	4	9
18. Company policy	2	4

The seven most common topics discussed in the samples are important and recurring matters in almost every company. It would appear that these should always be discussed unless exceptional circumstances eliminate their significance. On the other

hand, the remaining topics, referred to in less than one half of the sample letters, would not be mentioned unless material changes had occurred in these categories during the year.

Readability

In order to perform its main function of interpreting the results of the company to the average shareholder, the letter must be understood by the technically uninformed. To test the readability of the reports, the Flesch³ formula was applied to 12 of the directors' letters selected at random from the original sample.

Results showed an average reading ease score for the 12 companies of 40-difficult, with all scores lying within the overall "difficult" classification. This average score is significantly similar to an average score of 34.37 which was obtained in a study of 26 United States corporations!

The conclusion which may be drawn is that directors' letters are much too difficult for the average reader to comprehend easily. The sentences are too long and the words have too many syllables. Until this situation is remedied, directors' letters will continue to provide difficult and dull reading for the shareholders who receive them.

The "Ideal Directors' Letter"

A number of both general and specific recommendations for the "Ideal Letter" are presented herewith to assist directors in their responsibility for the adequate reporting of company affairs.

³ This formula was developed by Rudolph Flesch, Ph.D., who has devoted himself to the study of language, reading and writing within the realm of psychology.

He has applied these principles as consultant on readability for the Associated Press and is the author of several books on the subject.

A. GENERAL RECOMMENDATIONS

The directors' letter should be placed near the beginning of the annual report and should be attractively titled to catch the reader's attention. Sub-headings preceding each paragraph also add to the appearance as well as to the ease of comprehension.

The length will vary according to the specific situation and will be strongly affected by the extent of information in the other sections of the report. As a general rule, the letter should be as short as possible, yet clear and comprehensive. Most readers are certain to lose interest somewhere short of the finish line in a 15 page directors' letter.

Topics should be presented in logical order of importance and the sequence used in discussing "Proposed Topics" in part "B" is suggested. The paragraphing is even more important. Only one central thought should be advanced in each paragraph — "mixed paragraphs" are a serious source of confusion.

Directors must write in a simpler style if they are to clearly convey their thoughts to the reader. This involves the use of shorter words (fewer syllables) and a drastic reduction in average sentence length. This is the most important single factor causing difficult comprehension.

Since the directors' letter is primarily for the benefit of shareholders, it should discuss topics from their point of view. It should be addressed to the shareholders and could well make occasional references to them in a subtle manner.

B. PROPOSED TOPICS

The topics suggested here are designed to present a working founda-

tion for a directors' letter, to be used to the extent that they apply to any given company, but subject to any special requirements of the company.

Only 11 of the 18 topics found in the study are suggested as the basis for a good directors' letter. Inclusion of all topics would make the letter too long and complex. The other seven topics would only be used if warranted by special circumstances.

Sales: Sales may be adequately presented by comparing the dollar amount of current year's sales with that of the preceding year. The 1953 annual report of International Metal Industries reports sales in a clear concise manner as follows:

Net sales for the year were \$35,673,000, the highest in the history of the company, and represent an increase of 28% over the sales of \$27,779,000 reported for 1952. This increase resulted chiefly from the production of defense supplies at the Conshohocken and Chicago plants, and also from higher volume of the company's regular products.

Earnings: A proper presentation of this topic would include a two-year comparison of net income, as well as earnings presented on a per-share basis. The following excerpt from the Crown Zellerbach annual report for 1953 is a good illustration:

Net income for the year was \$3,893,240 compared with \$3,120,344 for the preceding year, an increase of 25%. Net earnings on the ordinary shares equalled \$5.03 per share after providing for the preference dividend. Net earnings on the same basis for the previous year amounted to \$4.00 per share.

Dividends: A brief summary of dividends paid out over the last year would constitute adequate discussion of dividends. The 1953 annual re-

port of the Fraser Companies provides a good example:

During the year dividends totalling \$4.75 per share were paid in quarterly installments to preferred shareholders. Common shareholders were paid four regular quarterly dividends of 25c per share.

Surplus: There are four items which should be referred to under this heading. These include additions (or deductions) for the current year, the balance in the account, extraneous items of a significant amount affecting surplus, and other surpluses. A concise statement of current earned surplus appears in the 1953 annual report of International Metal Industries as follows:

Retained earnings as of December 31, 1953, were in the amount of \$9,569,000, an increase of \$592,000 over the prior year.

Working Capital: This topic should be adequately described without presenting too much detail, by stating the present net amount, changes during the previous year, and brief reasons for the increase or decline. The directors' letter in the 1953 annual report of the St. Lawrence Corporation provides an adequate illustration:

As a result of the substantial capital expenditures made by the Corporation during the year, net working capital decreased from \$31,254,274 as at December 31, 1952, to \$21,503,989 as at December 31, 1953.

Fixed Assets: A concise summary of important plant and equipment additions and disposals should be presented under this heading. This is also an appropriate place to describe an expansion program, as Dominion Foundries and Steel has done in its 1953 annual report:

Your directors, having faith in the future of Canada and Canada's steel industry, decided on a modernization program costing \$15,000,000. Of this \$5,000,000 was spent during the year and equipment covered by the balance of \$10,000,000 should be installed and operating by August. Every dollar of this program is spent for lower costs, higher quality steel and new products.

Bonds and Capital Stock: A good directors' letter should provide brief details of changes in the capital structure below this topic heading. It would include a description of new stocks or bonds issued as well as details of any redemptions within the last year. The 1953 Canada Steamship Lines annual report provides a good example:

During the year serial bonds in an amount of \$400,000 matured and were paid and \$111,500, 1948 Series Bonds were retired through the sinking fund leaving outstanding fixed indebtedness of \$7,628,500 of which another \$400,000 matures as of March 15, 1954.

Affiliated Companies: In most cases, a few remarks in general terms regarding the operating results of subsidiary companies will prove adequate. A more detailed discussion would be beyond the proper scope of the directors' letter but should be included in the notes to the financial statements. Oakville Wood Specialties, in its 1953 annual report, describes subsidiary results in this manner:

The showing of Dominion Plywoods was particularly pleasing and I believe this subsidiary and the basket business will continue to show good prospects in the coming year.

Officers and Directors: This is the heading under which changes in top management personnel should be reviewed for the benefit of the share-

holders. Montreal Refrigerating and Storage treats this subject very well in its 1953 annual report. An excerpt follows:

Mr. W. G. Lasher, the president of your company, advised the Board of his desire to retire from business and resigned as president and as a member of the Board of Directors on May 1, 1953, and was succeeded as president by Mr. Frank B. Common, Q.C.

Outlook for the Company: The directors should state their considered opinion regarding future prospects for the company, and should indicate the basis upon which their opinion is founded. The directors' letter in the 1953 annual report of the St. Lawrence Corporation presents future prospects very clearly:

It is anticipated that the demand for newsprint and finished kraft products will remain steady for the coming year. With the additional productive facilities at Red Rock and East Angus, the total tonnage of all finished grades should materially exceed that of 1953.

Employee Tribute: This is one of the most common features of current directors' letters and should never be

overlooked. It should consist of a simple, direct "thank you" to the employees for their services during the year under review. An example is provided by the 1953 annual report of H. Simon & Sons:

Your Directors are pleased to record their deep appreciation of the loyal and faithful manner in which all officials and employees of the company have performed their duties.

Summary

In beginning this study, the significant functions of directors' letters were suggested. The detailed analysis indicated many inadequacies in current directors' letters and recommendations for improvements have been advanced. In many instances corporate shareholders are not being given the properly presented comprehensive information to which they are entitled, particularly through their directors' letters. It appears, however, that corporate directors, through better recognition of the problem, are now improving and will continue to improve their annual letters.

Summary of U.K. Royal Commission Report on Taxation of Profits and Income

J. HARVEY PERRY

ONE OF THE most important events in taxation in some years was the recent publication of the final report of the U.K. Royal Commission on Taxation of Profits and Income. Along with the two preliminary reports of the same body and the first and second reports of the so-called Tucker Committee there are now available about 900 pages of well considered argument by some of the best brains of England on one of the major phenomena of the age — the income tax. That these talented people were far from unanimous in their views is reflected in the strongly worded dissent in the final report, which in effect represents a sixth report. The very embarrassment of these riches makes it impossible to compress more than a brief summary into a short article, and the main justification for even attempting this is that it might encourage some readers to delve into the report itself. It is quite readable, and even the most casual inspection will be well repaid.¹

Some General Assumptions

As a basis for its general approach the majority report made the assumptions that: (1) as long as the weight of taxation is heavy, defects in the law will be glaringly apparent but it is futile to attempt to remedy all of them; (2) the law will of necessity be complicated because of the variety of conditions and circumstances to which it must apply; and (3) there will be no marked further inflation or deflation in the United Kingdom. The first two of these assumptions are almost beyond argument, although one can agree with the Commission in its warning that "there is a limit beyond which the refinements of a tax system cannot be allowed to go". The third assumption — no further inflation or deflation — has been challenged by many economists. Since this assumption profoundly influenced the attitude of the Commission towards such matters as valuation of fixed assets it introduced an additional element of contention regarding issues

¹ As a compromise the reader can refer to the excellent digest of all these reports issued by the Federation of British Industries, entitled "Taxation of Profits and Income". The Canadian Tax Foundation

has available a limited supply of these booklets which can be obtained for 50 cents a copy by writing to the Foundation at 191 College Street, Toronto 2B, Ontario.

which were bound to be the subject of lively dispute in any event.

The Nature of Taxable Income

This question is one of the most perplexing in the whole income tax, but the Commission attempted nevertheless to give an answer. At least it gave two widely divergent answers, because nowhere does the marked difference in philosophy between the majority and the minority emerge more clearly. The majority view was that the general basis of the "English" concept was still valid — that no income emerges until there is an actual receipt, and that the nature of any receipt as taxable income can only be determined by considering its status in the hands of the recipient. Furthermore, "To determine its status it is not relevant to enquire whether the payer charges it to his income or his capital account, from what resources of his it may have been drawn, or whether it would be a deductible expense in his own computation of taxable income." The majority also affirmed, regarding deductible expenses, that "There is no taxable income until the necessary cost of obtaining the receipts has been properly computed. It is desirable to say this explicitly because the language of the tax code is often rather grudging on this point." The majority also rejected the idea of attempting to define income in any more precise terms than under the present law.

By contrast the minority wanted to introduce a whole new concept of taxable income, one much more similar to the American. "In our view", it said, "the taxable capacity of an individual consists in his power to satisfy his own material needs, i.e. to attain a particular living standard. . . . Thus the

ruling test to be applied in deciding whether any particular receipt should or should not be reckoned as taxable income is whether it contributes or not, or how far it contributes, to an individual's 'spending power' during a period". This statement may by itself sound rather philosophical, but it led, as will be seen in a moment, to the concrete suggestion by the minority that a capital gains tax should be levied in England.

Taxation of Companies

A great deal of the report is devoted to the question of the way in which corporations should be taxed. Whereas for nearly a century before there had been no "double" taxation of corporate profits, there has been an element of it in England since 1937, first under the national defence contribution and latterly under the profits tax. The majority accepted the validity of all the criticisms directed against "double" taxation but, finally, and with very evident misgivings, agreed that to provide revenue and to compensate for the advantages of tax postponement on undistributed income a small separate corporation tax would have to be tolerated. It urged however that the present "profits tax" be revised to eliminate its highly discriminatory rate on distributed profits. The recent move in the British budget to increase this discrimination has therefore gone directly contrary to one of the Commission's principal recommendations.

The minority disagreed on "double" taxation. It argued for a reasonably high separate corporation profits tax (a rate of about 33-1/3% was suggested) and continued discrimination against distributed profits until a capital gains tax is imposed.

Capital Gains Taxation

Undoubtedly the most contentious question considered by the Commission was the issue of a capital gains tax. The minority, on the general grounds indicated above, argued for such a tax in the strongest terms. But the majority were firmly opposed, and since our law follows the English precedent fairly closely in this vital matter it is interesting to consider the arguments presented against a capital gains tax.

Developing its analysis step by step the majority first establishes the point that the question at issue is not one of a separate tax on capital as such but whether "certain profits, styled capital gains, which are at present excluded from computation on the ground that they are not income, ought properly to be included within the scope of the taxation of income". It next eliminates the possibility of taxing an *unrealized* rise in the value of property, since any such system would be impracticable. It then comes to the core of the present position — what is the legal concept of income under the present law in England? "The doctrine that now prevails may be summed up by saying that the profit from an isolated transaction in property is not as such exempt from taxation; but that since only profits that are of the nature of income are to be subjected to an income tax, the law has tended to identify taxable profits as those which arise out of something more substantial than the mere occasion of the profit itself This substance is to be found where the person concerned has been conducting a venture or concern in the nature of trade out of which the profit arises. That is equivalent to saying that he was a dealer, even if he made only one deal."

Having established the general character of the present system the majority then examines the problems in a specific tax on capital gains. A tax such as the American is extremely complex and must be so to be at all fair. To be reasonable a capital gains tax should not tax as the income of one year an increment that accrued over several years, and a division should be made between long term and short term gains. Capital losses should also be allowed against income in full and certain kinds of capital increments should be exempt. There is no sure way of distinguishing a gain made on an innocent change in investments or an involuntary realization of property from a deliberate profit-making deal. Increments in share values which arise because of corporate earnings are counter-balanced by the corporate profits tax. No substantial revenue would come from such a tax nor would its effect in taxing expenditures not now taxed be important. In short the majority rejected a capital gains tax for a variety of reasons, but the reason which seemed most clearly to reflect the social and economic chasm between it and the minority was stated in these words: "Those who advocate such taxation are, we think, responding to a feeling which is the product of disappointment at the failure of high taxes on income to restrain all lavish expenditure by the wealthy". In fact, however, "a tax on these lines would be likely to create at least as many inequities as it would remove".

The majority were not wholly content with the present position, however, and attempted to list six characteristics by which it felt a "trade" could be identified. These related to (1) the subject matter of the realiza-

tion; (2) the length of the period of ownership; (3) the frequency of similar transactions by the same person; (4) supplementary work on it or in connection with the property realized; (5) the circumstances that were responsible for the realization and (6) motive. Of the relevance of motive — or “intention” — as a test it expressed serious misgivings. “We regard a test that depends on the motive or view of a person at the date of acquisition (which may have occurred years before the question comes up for review) as a bad general test for the purpose we have in mind . . . if motive is to be ascertained, it is better ascertained by being imputed as the automatic result of prescribed conditions than by an attempt to search the mind of the taxpayer himself.” Thus intention is to be imputed entirely from course of conduct rather than inferred from the taxpayer’s own statements.

Deductible Expenses

The Commission adopted the “liberal” approach towards deductible expenses. It rejected the notion (implicit in our own *Dominion Natural Gas* case) that every expense must be directly related to some identifiable revenue in order to be deductible, citing advertising and entertaining as examples of outlays which were not so treated now. The words of the statute it found were sufficiently broad but had been too narrowly interpreted by the courts (particularly in *Strong v. Woodfield*). It therefore proposed that the case law be declared null and void by a statutory amendment. Also of interest were its recommendations regarding expenses incurred by employed persons. Here it did propose some relaxation of the wording,

which now applies the double test that the employee was “obliged to expend” the money and did so “in the performance of the duties”. The proposal was that the test be reworded to allow “all expenses reasonably incurred for the appropriate performance of the duties of the office or employment”.

Fixed Assets and Inventory Valuation

The report’s discussion of allowances for fixed assets echoes the clash of arms of the “replacement value” and “original cost” schools. So much has appeared elsewhere on this subject that the discussion in the report is an anti-climax. It is a well-reasoned presentation of both sides of the case and is well worth reading, but suffers from the influence of the underlying postulate of no further drastic price changes. It finally rejects any system but historic cost on the grounds that: “Historic cost accounting is the system which offers greater certainty”; if any other basis than cost were to be adopted for the business computation “it is hard to see how far its principle might not have to be imported into other relations than those between taxpayers and Revenue”; and “Historic cost seems to us to hold the scales with a more even hand in the accident of replacement”.

Some extension of the present allowances should be made, however. The report accepted the general principle that capital allowances should provide for the wastage of all assets used up in carrying on a business, and that in time all such assets not now covered should be brought into the allowances (the principal not covered now are non-industrial buildings). The Commission also proposed a gen-

eral system for recovery of excess depreciation on the sale of an asset to replace partial provisions now in effect, and urged that the distinction between "structures and adaptation of land" be dropped and that an allowance be granted for "cutting and tunnelling work".

On inventory valuation ("stock in trade") the Commission came to the interesting conclusion that it would be unwise to adopt any single method of inventory valuation in the law, but that where the circumstances were appropriate, "*Fifo*", "unit cost", "average-cost", "base stock", "*Lifo*", or any other reasonable method should be allowed. It rejected the contention of the Revenue authorities that *Fifo* was sanctified by universal and traditional usage in England, or that it had any inherent virtues as a method of valuation. It somewhat mistakenly referred to the "U.S.A. and Canada" as places where "in recent years many businesses . . . have adopted the *Lifo* basis". It cited the *Anaconda American Brass* decision as one in which "the Exchequer Court of Canada has affirmed the propriety of its use in Canada for the purpose of computing taxable profits", a reference which would have been more accurate had it mentioned that the case arose under the Income War Tax Act and was being appealed to the Judicial Committee of the Privy Council.

An appendix to the report sets out a scheme for valuation of inventory which the Commission feels would permit departures from the *Fifo* basis and at the same time adhere to the two fundamental principles which it believes should govern any method, namely that it "(1) is designed to secure that the cost assigned to any item of stock in trade represents a

real figure for the cost of that item and is not arrived at by any arbitrary or fictitious process; and (2) is calculated, if used consistently over a period of years, to give a fair reflection of the profits of each year".

The scheme proposed is said by the report to have the virtue that "despite rising prices, there is no permanent exclusion from taxable income of an element to reflect the fall in the purchasing power of money".

The chapter discussing inventory valuation* is a brief and lucid exposition of the role of this process in the computation of profit.

Many Other Questions Covered

A multitude of other matters was dealt with in the report warranting fully as much comment as has been given those already mentioned. Briefly listed, some of the other recommendations are:

Savings: the recommendations of the Tucker Committee on the Taxation Treatment of Provisions for Retirement relating to pension plans for the self-employed were endorsed (with one minor reservation) as were the other recommendations of the committee.

Charities: it was proposed that the definition of charity be more narrowly drawn to restrict the scope of the tax exemption now granted.

Fluctuating incomes: general systems of averaging were examined and rejected; it was recommended however that where a drop of 50% or more occurred between years that total income be averaged over two years.

Benefits in kind: no suggestions for

*Editor's note: This whole chapter will be reproduced in the next issue of the magazine.

stricter rules were made but a general warning was given that the development of tax-free fringe benefits to employees would bear close scrutiny in the future by the tax authorities.

Compensation for loss of office: all payments of this kind, hitherto tax exempt, should be made taxable.

Post-cessation receipts: receipts in the form of delayed remuneration or recovery of bad debts, now tax exempt if received after cessation of a business or profession, should be made taxable.

Foreign income: the concepts of residence, ordinary residence and domicile should be clarified by statute. The governing criteria should be, among others, that (1) the fact of having an abode in the U.K. should not establish residence, and (2) the test of "ordinary resident" should be reduced to a time basis.

Overseas profits: a new type of corporation — the "overseas trading corporation" — should be established in the tax law. The profits of such a corporation would be exempt from U.K. income tax and tax on dividends distributed by such a company would apply only at the "net U.K. rate".

Business taxation year: the taxation year for businesses (Schedule D) should be changed from the previous to the current year.

Losses: no change is proposed in the existing scheme for offsetting losses.

Depletion: a depletion allowance should be granted for the cost of acquisition of a mining property. However, the allowance should be limited to cost; percentage depletion is rejected.

Mutual trading: reserves of certain forms of mutual organizations — mainly mutual insurance companies other

than life — should be taxed. Otherwise the existing treatment for co-operatives is satisfactory.

Reserves for unincorporated businesses: the Commission could not accede to requests that unincorporated businesses be allowed to set up reserves out of taxable income.

Capitalization and capital profits: in general the Commission approved the existing law and practice under which the issue of stock dividends or bonus shares does not create taxable income. However it proposed that all cash dividends, including those paid out of capital surplus, should be subject to tax.

Income from property: the Commission rejected a recommendation of the first Tucker Committee that a premium on a lease be allowed as deductible expense. It said it should not be allowed because it was more in the nature of purchase price than a payment in lieu of rent.

Cost of tax appeals: no allowance should be given for such costs.

Tax avoidance: in general the Commission favoured a series of specific provisions directed against definite schemes of tax avoidance in preference to an overall statutory device (such, one supposes, as our non arms length apparatus) and was prepared to have more of them added in the future. Existing measures should be reviewed by an expert committee to assure that they were not too wide in their scope.

Tax evasion: to overcome evasion all "traders" should be required to keep books and more authority should be given to enforce production of documents. Another expert committee should also review the penalty provisions of the existing law.

Codification: much as it is to be desired a complete codification of the existing body of case and statute law is out of the question. However, the Commission urged that when any part of the law is revised the whole should be codified, that there be a consolidation every ten years, and that every effort be made to express the law in clear statements of principle rather than in detailed enactments to cover every conceivable situation.

On this last point of legislative drafting the report offers up some words of wisdom with which it would be appropriate to close this article; certainly every tax practitioner will echo them as a silent prayer:—

“We do not feel satisfied that it is impossible to introduce greater clarity and concision into the drafting of income tax legislation. . . . We accept that there are several

valid reasons why income tax legislation should be difficult and obscure. Not infrequently its conceptions represent an attempt to dress what are really mathematical formulae in the vesture of English prose. It has established its own jargon and perhaps does well to stick to it. The increasing importance of anti-avoidance legislation has led both to an extreme vagueness of expression in some parts of a section, in the hope of covering anything unforeseen, and to an extreme minuteness of definition in another part of a section, under the resolution of covering everything foreseen. All this can be said with truth; but, with it all conceded, we remain under the impression that the possibilities of an improved technique are not exhausted and some advance could still be made in the way of clarity.”

The Quebec Institute 75th Anniversary Banquet

The 75th anniversary dinner and dance of the Institute of Chartered Accountants of Quebec was held at the Sheraton-Mount Royal Hotel in Montreal on the evening of December 7. Some 600 guests were present and were received by the president of the Institute and Mrs. W. S. Munro.

His Excellency, the Rt. Hon. Vincent Massey, Governor-General of Canada, was the guest of honour and others at the head table included John H. Zebley, Jr., president, The American Institute of Accountants; Gerald E. Martin, president, The Canadian Institute of Chartered Accountants; H. G. Norman, C.M.G., Consul General for Canada in New York; C. Hugh Hanson, vice-chairman of the Executive Committee of the City of Montreal; F. Simard, president, The Quebec Chamber of Commerce; S. M. Finlayson, president, The Montreal Board of Trade.

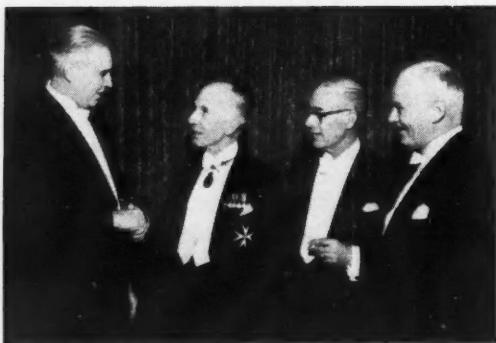
The president of the Institute, William S. Munro, said in part:

Starting with a small group of ten persons in Montreal in 1879, chartered accountants now total 2,100 in Quebec and 6,400 across Canada. The development of our profession parallels that of our country, as the Quebec Institute was born only thirteen years after Confederation, and public accounting in Canada has emerged from being little known or recognized to a highly respected profession.

The charter members of the Quebec Institute who laid the foundation of the accounting profession in North America represented a combination of Scotch, French and English speaking citizens. This combination still exists and as a Canadian of Scottish descent, perhaps I may be excused if I put the importance of the three groups and the three languages in that order.

Mr. Munro then paid respects to Major-General J. G. Ross who became a chartered accountant in 1884 and is the Institute's oldest living member. He continued:

It has been our practice to recognize in some tangible form services rendered by members who have been in our Institute for long periods and we have with us tonight a gentleman who this year is celebrating his 50th year as a member. Mr. Lemuel Cushing became a chartered accountant in 1905, has served in past years as a member of our Council and in 1925 was president of the Institute. He has given a lifetime of service to his fellow citizens and we are all deeply indebted to him for



(Left to Right) John H. Zebley, Jr., president American Institute of Accountants; Governor-General Vincent Massey; Gerald E. Martin, president, C.I.C.A.; William S. Munro, president Quebec Institute.



(Left to Right) William S. Munro, Msgr. Irenée Lussier, University of Montreal; Governor-General Vincent Massey; Prof. Eric W. Kierans, McGill University; Rev. Frère Clement Lockquell, Laval University.

preciate the invitation which has brought me here. I have many friends in your profession and in your Institute, and this gives me an added pleasure to be here this evening.

Qu'il me soit permis d'adresser un mot, dans l'autre langue de notre pays, à ceux dont c'est la langue maternelle. Le groupement qui célèbre ce soir son soixante-quinzième anniversaire fournit un excellent exemple de collaboration pratique entre des membres de nos deux grandes races, dans un domaine commun. Votre profession — comme d'autres — réunit Canadiens de langue française et Canadiens de langue anglaise en vue de l'accomplissement d'une même tâche, sous le signe de cette camaraderie née d'une communauté de problèmes, d'intérêts et de réalisations.

The chartered accountant is the symbol of steady honest progress, of law and order, of system and method — the only durable foundation for the boldest enterprise. And it is fitting that we should celebrate today 75 years of your history in the Province which founded Canadian business. You have made your profession distinguished in Canada and abroad. Canada is, I believe, a notable exporter of accountants who carry abroad with them the sober, patient diligence, lightened

by imagination, insight and humour for which we must, I think, often thank our Scottish forbears as well as their Canadian descendants. I am happy to think, however, that we are keeping so many of our accountants at home. In a country entering on a great, exciting and possibly hazardous period of expansion, we need these quiet keepers of our conscience.

Continued on page 76

his many contributions to the profession and to the well-being of the community.

Before calling upon His Excellency to address the gathering, the president asked the Governor-General to make a presentation to Mr. Cushing on behalf of the Institute.

His Excellency, the Governor-General, then addressed the gathering, and said in part:

I am very glad indeed to be able to foregather with you today and I much ap-



Governor-General Vincent Massey makes presentation to Lemuel Cushing.

The Valuation of Shares of Private Companies

HAROLD E. CRATE

"WHERE OH! death is now thy sting? Where grave thy victory?" We have answers to these questions, although perhaps not those that the author had in mind. The victorious sting is administered by succession duties and estate taxes, and it is sometimes especially painful when applied against unrealized or unrealizable values attributed to the shares held at the time of death in private or closely held companies.

An Incomplete Picture

In valuing the shares of public companies which are traded on exchanges, quoted values, of course, are used. Presumably these reflect the prevailing opinion in the market place as to their real value at the time. In reaching these values, the trading public has reference not only to past earning and dividend experience, financial position, etc., but it also looks forward and assesses prospects of decline or growth. In the case of the closely held shares, however, an attempt is made to promulgate the value by the application of certain traditional formulae and procedures. All of these procedures glance backward over the recorded history of the company up to the date of death, and

give little, if any, consideration to the forward looking factors which influence the market price of listed securities. This is not always bad for the taxpayer, as obviously the variation could work either way, but in the cases where it is felt to be a disadvantage, because the line of earnings tends to decline in later years, it is important to produce all those facts and arguments which can legitimately be used to lower the valuation for succession duty purposes.

Valuations of shares provide the widest range for difference of opinion where such value cannot be determined by reference to quoted values on stock exchanges. The explanatory brochure to the Succession Duty Act makes short work of this problem in the following words:

"Inactive stocks and stock in a close corporation are valued on the basis of the company's net worth earning and dividend paying capacity and other relevant factors bearing on the value of the stock."

Two Data Sources

In line with this rather broad principle there have developed, in the succession duty valuation departments, two main data sources which

are used in valuing these shares. They are (1) earnings over a period of years and (2) the company's latest balance sheet.

Whether the valuation problem involves succession duties, gift taxes or merely the establishment of acceptable values for a non arms length sale, the principles used are similar and in the case of the federal government will all be dealt with by the same valuers. The annual statements normally prepared by private companies should not be used, without adjustment, as a means of showing either the earnings or the equity values. The income accounts may include items which cannot recur while the balance sheet will show values which are proper for purposes of a going concern but which could not be realized upon a break up and distribution.

There is always the interplay between the value as it might be construed by reference to earning power and the basic value as reflected by the present assets and liabilities. This latter value is referred to as "net worth" or "equity" or "break-up" value. No settlement can be looked for, especially for a majority holding, which would be less than this break-up value. The factors which influence the valuers in deciding whether such a minimum value is appropriate or whether a higher value based on earnings should be used are as follows:

EARNINGS RECORD

While a five year period of earnings is usually most readily acceptable to the department valuers, ten years can often be shown to be more appropriate especially where the business concerned is highly susceptible to economic fluctuations. The earnings

are tabulated, of course, after all corporate taxes on income and should be exclusive of earnings sources which cannot recur. The average annual earnings so derived are multiplied by a factor which may vary from 5 to 10 or even 11 depending upon the earning risks inherent in the industry or, if available, as reflected for that industry in published figures. The resulting amount is known as the "capitalized earnings" valuation which can then be considered in relation to equity value per share. If the earnings basis is higher, then the average of the two values is frequently used.

WHERE REFERENCE TO EARNINGS NOT APPROPRIATE

When the circumstances are such that the right to continue the earning of the income is seriously in doubt, only the equity (or static) value of the shares is realistic. Such circumstances exist when the business depends for its existence on a franchise, such as an automobile dealer, on a personal connection of the deceased or on contracts which have a limited life. In other words, an earnings valuation should not be used when earnings as they have been in the past cannot be conveyed by inheritance or otherwise with any assurance of continuity.

DEGREE OF CONTROL

Shareholdings which represent a controlling interest are worth more, for obvious reasons, than are minority holdings. Therefore, if the voting shares held for valuation are a minority block some reduction of value should be expected under values promulgated as above. Reference to the dividend record is advisable, especially where the controlling shares

are held completely at arms length to the shares in question.

AGGREGATE VALUATION V. CLASSES OF STOCK

Frequently, since 1949, an estate would include not only the common stock of a company, but also preferred stock received by means of a surplus distribution under s. 105 of the Income Tax Act. Usually these preferred shares are "defenceless" issues, that is, they have no voting or cumulative dividend rights. It is important that such shares should not be valued independently of the common stock as if they were publicly held. Their value should form part of the aggregate value derived from a capitalization of earnings and should be deducted at par from the total. The

balance remaining will be the value of the common shares. This will result in a substantially lower value for common shares than would result if each class of stock were valued on the basis of earnings attributable to it.

More and more frequently the valuation of shares of private companies arises prior to the death of the majority holder. This becomes necessary when estate planning includes the transfer of the shares to the intended ultimate recipients during the lifetime of the transferor either by means of the gift tax provisions or by a properly documented sale in which future settlement is arranged. This procedure often offers many advantages in addition to a more leisurely valuation process.

A LAYMAN'S GLOSSARY OF ACCOUNTING TERMS



Net profit.

Spotlight on Prospectuses

(Part III)

C. W. LEACH

THE PROVINCE of Ontario has taken the lead in the regulation of trading in and distribution of securities. Whether this came about as a result of a more progressive attitude or from a greater need for regulation is left to the judgment of the reader. In any event, the Ontario Act sets up a body known as the Ontario Securities Commission and provides among other things for the filing of a prospectus with the Commission for securities which are distributed to the public.

Ontario Requirements

The first requirement of the prospectus is a list of statutory information very similar to that required under the Dominion Companies Act. Two important additional items therein are certificates by the directors and promoters on the one hand and underwriters and optionees on the other hand to the effect that the preceding statutory information constitutes a full, true and plain disclosure of all material facts. In the case of the underwriters and optionees the certificate will say that they have relied upon the accuracy and adequacy of the preceding information in respect of matters which are not within their knowledge.

In practice, where a Dominion company is being registered in Ontario, the statutory information is set out in the pattern required by the Dominion Act but the answers are expanded in such a way as to include any additional information required by the Ontario Act.

Additional Points

The requirements for financial statements are also quite similar to those required under the Dominion Act, but the following additional points may be noted:

1. Subsidiary companies must be included "unless the Commission otherwise directs". This means that an exception may be made if the Commission can be satisfied that there is good reason for excluding one or more subsidiaries. Normally disclosure of the names of any subsidiaries so excluded is required but there may be cases where a company does not wish to identify its ownership.
2. The financial statements must be "in a form acceptable to the Commission", for the Commission may refuse filing of a prospectus if it is not satisfied with the form. This and the preceding point as well as

others indicate the advisability, and in fact the necessity, of agreeing the prospectus in draft form with the officers of the Commission before it is finally prepared and signed.

3. The Commission also has power to approve the date as of which the financial statements are prepared and thus may grant some leeway as regards the 120-day rule.
4. The balance sheet must be approved by two directors of the company, a requirement not included in the Dominion Companies Act; therefore the face of the balance sheet should provide for such approval.
5. The balance sheet must be accompanied by a report of the auditors of the company who shall be persons acceptable to the Commission. This would enable the Commission to refuse registration if the auditors were not properly qualified, if, for example, a member of the firm was or had been a director of the company.
6. The text of the auditors' report on the balance sheet is suggested and it must contain "a reasonably comprehensive statement as to the examination made". This leads to the inclusion of the sentence "Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and other auditing procedures as we considered appropriate in the circumstances". The final phrase of this sentence is required by the Commission in order to place the responsibility

for the adequacy of the examination squarely on the auditors.

Pro Forma Balance Sheet

A pro forma balance sheet, as additional information only, is recognized by the Ontario Securities Act, whereas the Dominion Companies Act is silent on the question. The Ontario Securities Commission will actually require the inclusion of a pro forma balance sheet in some cases, for example if another financing has intervened between the date of the balance sheet and issue being offered by the prospectus.

Any pro forma balance sheet must also be approved by two directors and reported upon by the auditors and be as at the same date as the regular balance sheet. It may be included if the Commission so requires or permits, but the preface must give a plain and full disclosure of the assumptions upon which it is based. The use of the word "preface" means that the explanation of the transactions reflected in the pro forma balance sheet must be at the top of it, or at least preceding it, and not following it in the prospectus.

Earnings Reports

The earnings report is referred to as "a statement with respect to net profits . . . accompanied by a report of the auditors of the company". Here is a fine distinction from the Dominion Companies Act, which, as already indicated, requires a "report". In practice, of course, either form is accepted provided it complies with the other essential characteristics. The earnings figures must be consolidated if there are any subsidiaries and must cover the last three completed financial years and any part of a subse-

quent financial year which is included in the balance sheet. Again the latter requirement is something which is not included in the Dominion Act and which could easily be overlooked. The Commission may also require additional periods not exceeding seven years where in its opinion further disclosure is desirable. Finally the text of the auditors' report is suggested by a requirement that they state "whether, in their opinion, such statement fairly represents the earnings for the period".

There are also requirements for the inclusion of earnings reports on businesses acquired or to be acquired. These are:

1. If the issuing company has been carrying on business for less than three years but has prior to the date of the prospectus acquired control of a business which has been carrying on business for a longer period, the earnings report shall be prepared as if the new company had been carrying on business for the same period as the acquired business.
2. If any part of the proceeds of the securities offered are to be applied in the purchase of a business then the requirements for the earnings report apply to both the company and the business.

Reference has been made earlier to the review of the draft prospectus by the officers of the Ontario Securities Commission from the legal point of view. The Commission has also a staff of accountants who review the draft at the same stage, and it is not at all unusual for them to ask for changes in the presentation of the accounting data.

The prospectus requirements of the

Ontario Securities Act are set out separately for three categories of companies — mining companies, investment companies and industrial companies, (this last including all those companies not falling within the first two categories). The provisions referred to above are in respect of industrial companies. The statutory information concerning mining and investment companies is somewhat more detailed and beyond the scope of this paper. The requirements for financial statements, while quite similar, include some additional disclosures.

The regulation of trading in mining shares has been an important part of the work of the Ontario Securities Commission. The Commission has made known certain standards which may be applied to these issues, as for example the proportion of a company's shares which may be issued to vendors for properties, the necessity of placing vendors' shares in escrow so that they may not be sold on the open market until the issue of a stated proportion of it is sold, and the gradation of prices in an option arrangement providing for shares to be drawn down in blocks.

The foregoing and various other informal statements of policy have appeared from time to time in the monthly bulletin issued by the Commission particularly in the earlier issues. These statements are of practical assistance on many points including even a reference to the undesirability of putting statutory information in small print.

Requirements of Other Provinces

All the other Provinces have legislation regulating the sale of securities within their own borders, but the

legislation and the regulations thereunder are far from uniform. Until recently they relied to considerable extent upon the requirements of the Dominion Companies Act and upon the control exercised by the Ontario Securities Commission and would accept for filing any prospectus qualified in those jurisdictions. However, as a result of the current development of natural resources in most of the Provinces and the consequent expansion of the securities market, some steps are being taken by the other Provinces to bring themselves up to date.

1. QUEBEC

The Province of Quebec requires, under the terms of the Companies Information Act, that a prospectus containing certain prescribed information be filed with the Provincial Secretary under certain circumstances, one of which is the sale of its securities in the Province. This prospectus is a printed form very similar to the annual return of information required under the same Act. It is customary to file with this return a copy of the prospectus which is being issued to the public in connection with the sale of the securities.

In Quebec, there is also a Securities Act designed to exercise control over security issuers, brokers, dealers and investment counsel, all of whom must be registered. The Act likewise provides for an independent audit of brokerage firms. It contains a provision that information required as to securities issued may be stipulated by order in council, but until recently no such order in council was passed. There were officers of the Department of the Provincial Secretary in the cities of Quebec and Mont-

real who were appointed to receive and scrutinize the prospectuses but since the contents of prospectuses had been left unstated (except as regards the provisions of the Companies Information Act) the Securities Act had not been a "disclosure" Act, the reason evidently being that the residents of the Province would not necessarily be protected thereby. The result was that the officers of the Provincial Secretary were in the difficult position of having to decide whether or not the quality of a security issue was such that it could properly be offered within the Province and their standard approach to the problem was to enquire as to whether at least 10% of the issue was being taken up by institutional investors, and if the answer was in the affirmative they would register the security on the theory that what was good enough for the professional investors was good enough for the general public.

The Quebec Securities Act has recently been re-enacted with certain important modifications. One of the new features is the creation of a commission of three members who administer it. The members have been appointed and have commenced to function.

The Act also contains the following novel and interesting provision which indicates that the Province is still not prepared to place its main reliance on disclosure as has been the case in other jurisdictions:

"The following are fraudulent acts within the meaning of this Act . . . (g) upon the occasion of a dangerously hazardous speculative transaction respecting securities, to abuse the credulity, ignorance, weakness or manifest inexperience in business of a person incapable of

estimating the risk involved in the transaction, and so to cause him serious prejudice"

Finally, there has been enacted an order in council covering regulations under the Act and these regulations now stipulate the information which must be contained in a prospectus. There is first of all the provision for statutory information regarding mining companies, investment companies and other corporations generally, and by and large these follow the pattern set by the federal and Ontario Acts. The requirements as to financial statements are indefinite. They state that there shall be transmitted with the prospectus "in the case of an investment company and of a corporation other than a mining company, recent and adequate financial statements containing all figures, information and exhibits required by the Commission and all other documents it may require". In the case of mining companies there must be filed, in addition to the foregoing, a report by a mining engineer, geologist or other qualified expert.

The Commission expects that drafts or proofs of prospectuses will be submitted to it for advance scrutiny. Its policy towards financial statements conforms to the established practice.

2. BRITISH COLUMBIA

The Province of British Columbia requires, under the provisions of its Companies Act, that a prospectus be filed in respect of public securities offerings. A variety of information is called for, roughly comparable to the statutory information required under the Dominion Companies Act and the Ontario Securities Act. The only accounting requirement is for a balance sheet signed by the auditors of the

company. In December 1954 a Committee of the British Columbia Institute submitted to the Premier of the Province a brief on suggested amendments to the British Columbia Companies Act which followed very closely the recommendations of the Canadian Institute to the federal government and it is expected that the British Columbia Act will be brought into line with the federal and Ontario Acts within a year or two.

3. ALBERTA

The Province of Alberta has a Securities Act, enacted in 1936, which is administered by the Board of Utility Commissioners. The Board has not laid down any specific rules or regulations, and each application for approval to sell securities in the Province is dealt with on its own merits. The Board is guided by the statutory requirements of the various Companies Acts and endeavours to ensure that there is full disclosure of all relevant facts.

The majority of applications dealt with by the Board are with respect to new enterprises, principally oil ventures, and being new enterprises there is no financial history so that this aspect does not achieve prominence. As in the case of the mining and oil companies under the Ontario Securities Act, the major emphasis is on the disclosure of the physical aspects of the company's undertaking, and on the bona fides of the promotion, including the adequacy of the company's resources to carry out the program, the validity of the title to its property and the retention of promoters' or vendors' shares in escrow pending the marketing of the shares offered to the public.

In those cases where securities of

established concerns are to be offered, it usually happens that an application has already been made to the Ontario or Quebec Securities Commission, and a prospectus accepted for filing in those jurisdictions will usually pass the Alberta Commission without difficulty. The same may be said for the requirements for financial statements.

4. SASKATCHEWAN

Until quite recently the Province of Saskatchewan relied on the requirements and standards of the Ontario Securities Commission in considering applications for the filing of prospectuses, and this situation has now received formal recognition through the enactment of the Securities Act effective September 1, 1954. This Act is a very close copy of the Ontario Securities Act so that any prospectus complying with the Ontario requirements can be expected to pass muster in Saskatchewan.

5. MANITOBA

In Manitoba the situation is somewhat different from the other Provinces. The Securities Act of that Province is administered by the Municipal and Public Utility Board, but the real control is exercised by the Winnipeg Stock Exchange through its Approvals Committee of which the registrar under the Securities Act is a member. This committee has au-

thority in those cases where securities are to be marketed through the medium of a registered broker, which is the more popular course. The alternative method is to make application direct to the registrar, but in either case the practice is to require the same type of prospectus and the same full disclosure required by the other Provinces.

6. MARITIME PROVINCES

The requirements of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland are the least well developed and the practice is to accept any prospectus for a Dominion Company as filed with the Secretary of State and any prospectus for a company incorporated under the laws of Ontario or Quebec if such prospectus contains the statutory information required by those Provinces.

The security commissioners of the various Provinces have met from time to time and had discussions on the desirability of making the requirements of the various Provinces uniform, but apparently these discussions have encountered the same difficulties as other conferences attempting to bring about uniformity in other fields. There can be no doubt that uniform requirements are highly desirable from the point of view of issuer, underwriter, solicitor and accountant.

(To be continued)

Accounting Research

The C.I.C.A.
Research Department

THE LANGUAGE OF FINANCIAL STATEMENTS

The most significant aspect of modern corporation finance is not the invention of new types of securities or the development of new forms of financial contracts, for example the post-war sale-and-lease-back arrangement; but it is to be found instead in the diffusion of ownership of corporate securities. The typical shareholder is no longer a man of great wealth or position; he (or she) is more likely to wear overalls (or a smock) than a homburg (or a Lili Dache).

The American Telephone and Telegraph Company has more than a million shareholders. The Bell Telephone Company of Canada has more than 124,000 and the Royal Bank of Canada has over 18,000. Imperial Oil Limited has approximately 45,000 registered shareholders, 37,000 of whom live in Canada. In these cases, as for many of the large corporations, the numbers are increasing yearly. Soon some inventive genius in a company secretary's or registrar's office may be moved to develop an elastic paper which could be stretched daily to accommodate the lengthening list of shareholders' names, and so destroy the supremacy of the card index.

What has been the effect of this change on financial reporting? On account of it, more and more Canadian companies are endeavouring

each year to express their financial results in more understandable forms and terms. They now recognize that many of those who read their annual reports do not possess the technical skill to interpret the highly specialized language of accounting. As a result much has been done in recent years to clarify accounting terminology, to simplify forms of financial statements and to teach accountants to express themselves in lucid, non-technical language.

Unfortunately, this progress towards a clearer presentation of financial information has been rather hampered by a lack of uniformity in reporting practices. Some variations, of course, are always unavoidable because of basic differences in circumstances and accounting policies. On the other hand, a good many variations, particularly those in methods of expression, are really quite unnecessary. These are apt to stem primarily from personal preference rather than from diversity in facts or policy.

The relative merits of variety and uniformity in reporting have been placed in sensible perspective by Jennie M. Palen, C.P.A. in her recently published book "Report Writing for Accountants":

"The financial position and operating results of a variety of businesses are, to be sure, more easily compared when the form and language of their financial statements are similar . . .

"Reasonable uniformity is much to

be desired. Complete uniformity, however, might well prove to be more misleading than helpful. It has been said that accounts can rise no higher in the scale of uniformity than the events which they reflect. In any set of financial statements the aim should be to express information fairly and clearly.

"Within these limits much can be done and should be done to achieve uniformity *Net profit, net income, income for the period, surplus charges, surplus*, and many other terms have been used by accountants to mean different things. We may clarify their meaning by listing or describing the items which they encompass, or, preferably, by evolving definitions of much-used terms and using these terms to express the prescribed meanings and no others

"The search for uniformity will not necessarily lead to stereotyped or perfunctory reports."

The author of "Report Writing for Accountants" has performed a notable service to the accounting profession in producing this work. The book can be recommended not only to every accountant but also to any person who seeks to express his thoughts in writing. Chapter 26, on "The Right Word," will make almost anyone squirm with embarrassment if not with remorse for his sins of commission. But let that report writer cast the first stone who has not overworked the word *indicate*: *indicated* in the paragraph above, *indicated* in the table, this fact would *indicate*, the results of our test *indicate* and so on, *ad nauseam*. There are times when uniformity in the use of words is not desirable, especially when, for example, words

like *state, express, suggest, give, show, and point* may be used with equal or greater clarity in place of *indicate*, and with much less monotony.

The degree of uniformity so far achieved in the language of financial statement presentation can be analyzed under two sections — terminology and classification. The former relates to the actual words, terms and expressions which identify and explain the various financial data. The latter is primarily a "reduction to order", the way in which words and figures are organized to disclose the true significance of the information.

Terminology

The statistical breakdowns which were made for "Financial Reporting in Canada" provide much factual evidence of unnecessary variations in the terminology of currently published financial statements. Many of the tables dealing with this aspect clearly show that similar types of information are designated by a miscellany of descriptions. For example, table 16(a) indicates that there were ten different expressions used to describe "accumulated depreciation". Table 38(a) discloses a similar lack of uniformity in the terminology for the current charge for depreciation in the statements of profit and loss.

To the practised eye a good many of the variations in wording appear to be immaterial. However, they often pose a real problem to the untrained reader. Consider, for instance, the asset "cash", which is one of the most common and perhaps the simplest item in financial statements. Sometimes it is described as "cash"; other times it is called "cash on hand and in the bank". Although most

readers would undoubtedly recognize that these two terms mean one and the same thing, the minor variation between them might be interpreted as an indication of differences in the actual nature of the funds.

No single variation of this type causes, by itself, any misunderstanding of the overall financial position but whenever a number of them are gathered together, the result can be complete confusion.

Table 18(b) from "Financial Reporting in Canada", set out below, has been selected as an illustration of the diversity of terminology used by accountants to describe the same type of thing. Again it is emphasized that complete uniformity is neither practicable nor desirable. However, many readers would be aided in their use of published financial statements, if some of the unnecessary variations, similar to those reflected in Table 18(b), were eliminated.

TABLE 18(b) — INCOME TAXES PAYABLE OR RECOVERABLE — (Cont'd)

	1953		1954	
	No. Co's	%	No. Co's	%
(b) Terminology				
(b.1) Income taxes payable				
Payable	78	30.5	88	35.8
Provision for	63	24.6	59	24.0
Taxes / income taxes / income and other taxes, etc.	48	18.7	52	21.1
Estimated	26	10.2	24	9.8
Accrued	14	5.4	10	4.1
Reserve	20	7.8	7	2.8
Payable and accrued	3	1.2	3	1.2
Balance of	3	1.2	1	0.4
Other	1	0.4	2	0.8
Total	256	100	246	100
(b.2) Income taxes recoverable				
Recoverable	12	52.2	8	50.0
Overpaid / overpayment	4	17.4	4	25.0
Estimated overpayment	1	4.3	2	12.5
Refundable	1	4.3	1	6.2
Receiver General of Canada	1	4.4	1	6.3
Overpayment and adjustment	1	4.3
Estimated recoverable	1	4.3
Balance recoverable	1	4.4
Refund recoverable	1	4.4
Total	23	100	16	100

Classification

Proper classification, the systematic grouping of items of a similar nature, is a fundamental requisite of effective statement presentation. As Mr. V. S. Tilly, C.P.A., has most aptly said, "Classification is to an accounting statement what sentences, nouns, verbs and paragraphs are to a writer. Little, if any meaning, can be obtained from an accounting statement in which the assets are mixed up with the liabilities, or retained earnings with the cash." (C.P.A. Handbook, 1953.)

In contrast to the wide diversity in terminology, there has developed, in recent years, a fair degree of standardization in the classification of financial data. For example, Table 7 of "Financial Reporting in Canada" shows that, "in 1954, 96.4% of the balance sheets followed a fairly uniform classification of items with groupings under descriptive captions and with extensions of totals or sub totals".

The balance sheets set out in examples 1 and 2 (pp. 45-6) have been included by way of contrast, to emphasize the improvement in the practices of classification which are generally accepted today. Example 1 was taken from the 1948 annual report of a Canadian company. Its defects of presentation are so obvious that they need no comment. Example 2, taken from a 1955 annual

report, is typical of the classification procedures which are now considered to be basic principles of fair reporting.

It is reasonable to expect that there would be a certain amount of variety in classification of some of the balance sheet items. A great deal of this is directly attributable to differences in circumstances peculiar to the individual companies. On the other hand, some variations are caused by fluctuations in accounting practices which have not yet been finally accepted or rejected. This is particularly true of the balance sheet presentation of "Reserves", and it applies also to the concluding point in statements of profit and loss.

One area of balance sheet presentation which does seem to suffer from "diversity" in classification practices is the shareholders' equity section. In 1954, 31.6% of the companies did not use a title for this section. In 67.4% of the balance sheets the earned surplus figure was carried into the shareholders' equity total, while in 32.4% this figure was extended as a separate total in the outside column. A large measure of uniformity and conformity appears, however, where statutory requirements are imposed as to disclosure of authorized and issued shares, par value, amount of share capital and rate of preferred dividend.

Example 1

BALANCE SHEET AT MARCH 31, 1948

ASSETS

Dominion Government Securities		
(Market Value, \$25,250.00)	\$	25,000.00
Sundry Debtors		44,840.89
Inventory of raw leaf, supplies and goods in process, at average cost or under, and advances for leaf purchases		4,549,101.28
		<u>\$4,618,942.17</u>
Investment in subsidiary company—		
Shares at cost	\$	10,000.00
Advances		2,352,960.97
		<u>2,362,960.97</u>
Shares in other companies		100.00
Refundable portion of excess profits tax		142,555.10
Real Estate, Buildings, Machinery, etc. (real estate at cost and buildings, machinery, etc., at replacement values as appraised by the Associated Factory Mutual Fire Insurance Companies on 20th June, 1923, with subse- quent additions at cost)		1,337,178.79
Prepaid and deferred charges		12,558.05
Goodwill and trade marks		2,478,672.06
		<u><u>\$10,952,967.14</u></u>

LIABILITIES

Bank overdrafts		\$1,195,784.19
Creditors:		
Creditors and credit balances		662,539.06
Provision for Dominion and Provincial Taxes		80,416.85
Dividend payable April 15, 1948, on Ordinary Shares		150,000.00
Dividend payable April 15, 1948, on Preference Shares		35,000.00
		<u>\$2,123,740.10</u>
Reserve for buildings, machinery, etc		\$1,157,490.65
Capital Stock — authorized and issued —		
20,000 Cumulative 7% Preference Shares of \$100.00 each	\$2,000,000.00	
25,000 Ordinary Shares of \$100.00 each	2,500,000.00	
		<u>4,500,000.00</u>
Deferred surplus-refundable portion of excess profits tax		142,555.10
Profit and loss account (earned surplus) balance per statement		3,029,181.29
		<u><u>\$10,952,967.14</u></u>

Example 2
Consolidated Balance Sheet
August 31, 1955
Assets

CURRENT ASSETS

Cash on hand	\$ 24,725.00	
Trade accounts receivable less allowance for doubtful accounts	6,734,439.06	
Other accounts receivable	157,650.54	
Inventories of raw materials and supplies, in process and finished merchandise at the lower of cost or market prices	9,145,863.32	
Insurance, taxes and other expenses prepaid	206,834.80	
Advertising stock, stationery and other supplies	216,450.64	\$16,485,963.36

INVESTMENT AND OTHER ASSETS

Investment in partly-owned subsidiary companies not consolidated	\$ 100,757.37	
Capital stock of affiliated company	200,000.00	
Sundry accounts receivable, including \$108.73 owing by shareholders	98,421.24	399,178.61

PROPERTY, PLANT AND EQUIPMENT

Land, buildings, machinery and equipment — generally at cost	\$9,527,204.29	
Less allowances for depreciation	6,293,590.73	3,233,613.56

INTANGIBLE ASSETS

Formulae, trade marks and goodwill		5,536,538.67
		<u>\$25,655,294.20</u>

Liabilities, Capital Stock and Surplus

CURRENT LIABILITIES

Bank overdrafts (net)	\$2,530,728.68	
Trade accounts payable and accrued liabilities	4,180,177.73	
Owing to affiliated company	46,912.77	
Income and other taxes — estimated	384,706.63	\$ 7,142,525.81

RESERVE FOR ALLOWANCES TO

RETIRED EMPLOYEES		20,000.00
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CAPITAL STOCK AND SURPLUS

Capital stock:

Seven percent, cumulative preferred, par
value \$100.00 per share:

Authorized — 40,000 shares

Outstanding — 34,600 shares

\$3,460,000.00

No par value ordinary:

Authorized — 225,000 shares

Outstanding — 224,720 shares

4,494,400.00

Earned surplus

10,538,368.39

18,492,768.39

\$25,655,294.20

Practitioners Forum

STYLE OF REPORT COVERS AND PAPER

The financial statements and reports prepared by public accountants are the chief visible results of the many hours of painstaking work required by their professional engagements. Clients tend to evaluate the type of service they receive from the quality and style of the reports and statements. Practically all accountants realize this and make a serious effort to produce statements and reports which look attractive and indicate a high degree of professional competence. At the same time, the practising accountant takes into consideration the cost and the efficiency with which they can be prepared in his office.

Ten firms of Canadian chartered accountants were circularized as to their practices with regard to report covers and paper, and although the number does not represent a reliable sampling, nevertheless, the results appear indicative of general practice. Details of the survey appear later.

Covers

The covers used are mostly grey, approximately 9½" x 12" in size, with a ruled margin. The name and address of the accounting firm is set out in a conventional style considerably below the centre of the cover. The name of the client and the particulars of the financial statements or reports are usually typed slightly above centre. Some covers allow the fast-

eners to show on the outside and others are folded so that the fasteners are concealed. One practitioner paid a professional artist \$100 for a letterhead design. He feels satisfied that his stationery has a modern look without being too unconventional.

Current publications on accounting practice indicate a trend to using smaller, letterhead-sized (8½ x 11) covers and statement paper than used to be the case. These will fit clients' and bankers' files more readily than the larger sizes. Mr. D. A. Ross of Calgary reports: "We have used a smaller sized paper for some years now and have experienced no unusual problems in connection with them. On rare occasions, we have had to create additional schedules because of lack of space, but in general we found that a letter-sized sheet will hold all the information which can be readily absorbed at one bite. Additional references are better shown by notes on a separate sheet."

Three eyelets are most frequently used for fastening the statements and covers together. Eyelets have the advantage of preventing any sheets from being readily removed from the report. Some firms thread coloured ribbon through the eyelets to set off the appearance of the statements. Longer eyelets may be obtained for lengthy reports requiring many sheets.

Introductory or front sheets are

often used behind the cover and contain much the same information as is shown on the cover. For the less important statements, an introductory sheet may be used in place of a cover. The auditors' report customarily precedes the financial statements, particularly if it is longer than two pages. The one page report may be found occasionally following the financial statements.

Paper

The paper usually has the name of the accountant printed at the bottom in small letters. Most paper is ruled with double or single red lines on four sides, although occasionally report paper is ruled only on the left hand side. For schedules too large for the regular sized statements sheets, the custom generally is to have a larger size sheet extending to the right which may be folded back and so kept within the regular cover. However, some accountants have "reverse sheets" so that a statement may extend from the left hand page over to the right hand page, divided by the fold in the centre. This style requires careful typing, and unless the horizontal line headings are repeated on the right hand page, it is better to keep the lines at least two spaces apart to permit the reader to follow them readily.

Mimeograph and multilith appear to be the most popular duplicating methods. Ditto duplicating is also quite practical although the purple ink tends to fade somewhat over the years. A great number of firms rely on typing with carbon copies as they feel that this gives a more professional appearance. Crinkle paper or other light paper of fine grade is required to produce multiple carbon copies.

Modern photographic reproducing methods may be widely used some day.

For special or bulky reports, covers of special board or imitation leather are sometimes put on. These may be made more impressive by imprinting with gold lettering.

Opinions differ as to which is the most satisfactory type of cover, statement paper and style. This difference of opinion is good for the profession. Each practitioner can express some measure of individuality and adopt a style which he considers to be most suitable for his particular clientele.

(The preceding comments were prepared by panel member C. K. MacGillivray of Hamilton.)

Individual Comments

Some correspondents are interested in experimenting with new styles but indicate they are staying with their present ones. Here are some of their comments:

"We enclose herewith a copy of our report cover and paper. The statement is bound together with one eyelet in the centre and is then tied with black ribbon. We use the crinkle paper for running off the tax runs at the same time as the other copies are made.

"We also use foolscap-size stationery which is backed by a linen cover. We do not, however, use very much of this.

"We have given some consideration to using letter size covers and affixing the statements solely by eyelets, but we believe that the larger cover with the statements tied with ribbon looks much better. We would want to continue in any event with that type of statement for many of our

clients. While we believe that the other type would be quite satisfactory for many clients, we have not gone ahead with it as yet since it would add greatly to the quantity of stationery that we would have to carry and we are attempting to hold this down to a minimum."

* * *

"I am enclosing a sample of our report covers and paper. There is nothing special about them; all I can say is we have consistently followed this style for the past 20 years. We have experimented with a semi-clear lead sheet, but we are not too enthusiastic. We do like the size of our report cover, as it fits into a letter-size file conveniently and is more practical than wide sheets frequently used."

* * *

"I am enclosing covers that we used on some occasions for the first time last year. They are of the same material as our normal report covers but are letterhead size. They are bound on the left hand side by two staples over top of which is placed gummed tape of either a blue or dark red color. We use these in cases where we want more copies in one run than we can get using the normal bond stock. In many cases, we prepare two copies of the statement on normal bond stock for use with our regular covers and five or six copies of statements on this light weight bond stock. We can use both stocks at the same time without difficulty even though the paper sizes are different."

From the Maritimes

Panel member A. F. Gosling of Moncton has some decided views:

"I feel we should try to 'dress up'

our reports to the best advantage — make them appear as important as possible, and use a little showmanship. We could follow the example of the food manufacturers who produce a very attractive package. The importance placed upon appearance is illustrated by *The Financial Post's* annual contest for the most attractive report put out by public corporations. An attractive and interesting appearing report will do a great deal to sell our product.

"We must guard against losing our individuality. It would not be good for everybody to use the same size reports or the same colours. Colours which will show up clearly the typing on the report cover are preferable. According to the questionnaire the most common colour was gray. This leads me to wonder whether we are a little too stereotyped and conservative. Gray is a dignified colour, but could we not experiment with some brighter colours? The trend today is for brighter colours for automobiles and clothing.

"Foolscap size stationery may not fit too well into some clients' files, but lawyers' reports and documents are of 'foolscap' or 'legal' size, and most clients can seem to find places to file them. I favour the legal size because it allows ample room for presentation and larger type can be used.

"Many firms use 'elite' type for their statements, but I would like to make a plea for the larger 'pica' type. This is much easier to read, the smaller type tends to crowd a lot in a little space and become bewildering.

"The fastening should be secure enough to make it difficult for anyone to take apart the statements after they have left the auditor's office. Some chartered accountants in Eng-

land use sealing wax to prevent tampering with their statements."

Survey

Here are the results of the "survey" of ten firms.

1. REPORT COVERS AND PAPER — for regular use

(a) Covers

Color

Light Grey	8
Light Blue	1
Light Brown	1

Ruling (4 sides)

Grey	2
Black	3
Blue	1
None	4

Size (approximate)

8½ x 11	2
9½ x 12	8

Fastening

3 Eyelets—showing	5
3 Eyelets—hidden	4
2 Eyelets—hidden	1

Is Ribbon Used?

Sometimes	2
Always	2
Never	6

(b) Front Sheet

(inside cover)

None used	3
Plain report paper	6
Glassine paper	1

(c) Paper

Is Name Shown? (other than on letterhead sheet)

— at bottom	5
-------------	---

— on back	2
— watermarked	1
— initials only	1
Not shown	1

Ruling

(a) Red	7
Grey	2
None	1
(b) 4 sides	6
2 sides	1
Left side	2
None	1

Letterhead

Engraved only	4
Printed only	6
Both used	0

2. DUPLICATION OF REPORTS

How many methods are used besides carbon paper?

None	6
Mimeograph	2
Multilith	2

3. SPECIAL PURPOSE

(report covers and paper)

Use	5
Do not use	5

4. LETTERHEADS

How many different varieties are used?

Both engraved and plain	3
Engraved only	3
Plain only	4
Interoffice	5
Personal—Firm name not shown	1

5. TYPE OF FIRM

National	4
Local	6

The Tax Review

RECENT SUPREME COURT TAX CASES

The Meaning of "Arms Length" under the Rule of Strict Construction

The above was the basic problem before the Supreme Court in the case of *Sheldon's Engineering Ltd. v. Minister of National Revenue*.

S, a minority shareholder in a company, and some of his associates arranged to purchase the majority shareholder's shares for \$360,000 with the aid of a bank loan. A new company was incorporated to acquire the assets of the old company, and S arranged with the minority shareholders of the old company to exchange their shares in the old company for shares in the new company. As a condition of granting the loan the bank had stipulated that 80% of the old company's issued shares should be transferred to the bank's nominees by way of collateral security and that the new company should issue bonds in the amount of \$300,000 to an underwriter approved by the bank, which sum should be used in reduction of the loan to S. On July 4, 1949, the new company was formed, the two companies entered into an agreement for the sale of the old company's assets to the new company for more than \$1,000,000, and the old company declared a dividend of more than \$500,000, which was payable to the new company as holder of all of the shares in the old company. It was contended by the Minister that the two companies were not dealing at arms

length at the time of the sale of the old company's assets to the new company, and accordingly that under ITA s. 20(2) the new company's capital cost allowances should be calculated on the basis of the capital cost of the assets to the old company rather than on the basis of the higher price at which they were sold to the new company.

The Supreme Court of Canada rejected this contention unanimously in a judgment pronounced on June 28, 1955 (Kerwin, C.J.C., Taschereau, Estey, Locke and Cartwright JJ.) The judgment is of importance today — notwithstanding amendments to the Act which have since come into effect — because of the Court's firm adherence to the rule of strict construction of a taxing statute.

The Court held that S did not, either alone or in conjunction with his associates, control the old company on July 4, 1949 at the time that the latter authorized the sale of its assets to the new company.

Said the Court: When S, pursuant to his arrangement with the bank, transferred the shares in the old company to the bank's nominees, he ceased to possess any voting rights in respect of those shares. At the time the old company authorized the sale it, said the Court, was completely controlled by the bank. (Furthermore, said their Lordships, at the time the new company authorized the purchase of the assets, S was not in control of

the new company either, although later in that same day S and his associates did control the new company when their application for additional shares in the new company was accepted.)

The Court went on to indicate that it was immaterial that the arrangements which the two companies carried into effect on July 4, 1949 were made in advance: the fact remained that it was the bank, not S, that was in control of the old company when the sale was made.

The Court concluded its judgment with these significant words:

Section 20(2) of the Income Tax Act may have been intended to cover a more extended field than s. 6(1)(n) of the IWTA but, if so, the nature of the extension has not been made clear. In *Partington v. Att'y-Gen.* (1869), L.R. 4 H.L. 100 at p. 122, Lord Cairns said in part:

"as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

The transaction in question does not fall within the letter of the law . . . and the respondent is entitled to . . . relief . . . The parties were at arms length within the commonly accepted meaning of that expression.

The Onus of Proof on an Appellant

Miron & Freres v. MNR was concerned with the self-same provision of the Income Tax Act as the case we have just been considering, but the facts were different and the result the opposite. Here, one of six brothers

bought a stone quarry for \$90,000 and some months later sold it for \$600,000 to a company which was controlled by the six brothers to the extent of 997 out of 1000 issued shares. The brother by whom the quarry was initially bought owned 200 of the company shares, another brother owned 200 shares, and the remaining four brothers held 150 shares each (less three in the case of one brother). On those facts, it was held by the ITAB, by the Exchequer Court (Fournier J.) and by the Supreme Court of Canada (Kerwin C.J.C., Taschereau, Kellock, Fauteux and Abbott JJ.), that s. 20(2) of the ITA applied, and that the company was only entitled to claim capital cost allowances in respect of the quarry on the basis of the capital cost of the property to the brother who had originally purchased it. The Supreme Court unanimously agreed that the sale by the brother to the company was not at arms length within the meaning of ITA s. 127(5)(a).

The case is perhaps more interesting for another aspect of tax law which arose and upon which the Court differed, though the difference did not affect the result. The question is one of considerable importance to the tax practitioner. It is the question of onus of proof in tax appeals.

In *Miron & Freres v. MNR*, the appellant company was content to rest its appeal upon a mere statement of the facts as set out above, and no additional evidence was adduced at the hearing of the appeal. The Chief Justice of Canada and Fauteux J. were of opinion that the Court should decide on those admitted facts whether or not the purchase of the quarry by the company from the shareholder was a non arms length

transaction within the meaning of s. 20(2). The majority of the Court, however, expressed themselves somewhat differently. Rejecting the company's contention that it was for the Minister to support his assessment by evidence relative to control of the company's shares, they held that since the Minister had concluded in the making of the assessment that the purchase was not at arms length, it was for the appellant to show error on the part of the Minister in that respect. And they cited *Johnston v. MNR*, [1948] S.C.R. 486 as authority for that view. The minority in their judgment had said that *Johnston v. MNR* was inapplicable.

The question to which this difference gives rise is this: Does a tax assessment give rise to a presumption that all the facts necessary to the validity of the assessment are true? If that is the case the burden on an appellant is not merely the affirmative one of establishing facts but is the negative one of rebutting presumed facts as to which no evidence has been given, and it will be appreciated that to prove a negative is often well-nigh impossible.

The ordinary rule as to onus in civil cases, as e.g. where the owner or driver of a motor vehicle involved in an accident on a highway must rebut the statutory presumption of negligence, is that after all the evidence is in the Court will decide on the evidence before it and only resort to the presumption where the evidence leaves the matter in doubt.

It may be that the rule in tax appeals is the same.

Gains Resulting from Changes in the Rate of Exchange

The Supreme Court has now re-

solved the vexed question concerning the adventitious gain to a trader resulting from a fall in the rate of exchange of Canadian for foreign currency. In *Eli Lilly & Co. v. MNR*, by a majority of three Judges (Kerwin C.J.C., Estey and Fauteux JJ.) to two (Rand and Locke JJ.) the Court has settled the issue in favour of the Crown. The gain, it is held, is in the nature of business income, and notwithstanding that the trader neither receives nor is entitled to receive any sum in the year in which he pays his debt to this foreign creditor the saving which he effects must be brought into account in computing his trading income for that year.

In *Eli Lilly & Co. v. MNR*, the appellant company purchased goods from a U.S. supplier during the years 1939 to 1945 to the amount of more than \$600,000 payable in U.S. funds. During this period the U.S. dollar was at a premium over the Canadian dollar, and each year in its books the company entered the amount of the premium for that year's U.S. purchases, and claimed a deduction of the amount in its tax return for that year though it did not pay its U.S. supplier for the goods purchased. At the end of 1945 the total amount of the premiums for the period in question amounted to some \$67,000. In 1946 the Canadian dollar returned to parity with the U.S. dollar, and the company thereupon paid its debt to its U.S. supplier at a saving of the full amount of the premium which it had previously set up. In other words, between 1939 and 1945 it had been allowed deductions for trading expenses which, by delaying payment, it was ultimately not required to pay.

In a somewhat similar case decided by the House of Lords in 1932, *British*

Mexican Petroleum Co. Ltd. v. Jackson, 16 Tax Cas. 570, a very strong Court had held that a trading company which was released by its trade creditor from payment of a trading debt incurred in a previous year was not chargeable to tax in respect of the amount of the debt forgiven, notwithstanding that in the previous year it had claimed a deduction for the full amount of the debt in computing its taxable income. The account for the previous year could not be reopened, held their Lordships, as the amount of the liability stated therein as the amount of the debt was correctly stated, and secondly, they ruled, a creditor's forgiveness of a trade debt was not equivalent to a trade receipt in the year of forgiveness.

In the *Eli Lilly* case the majority of the Supreme Court found a basis for distinguishing the *British Mexican Petroleum* case. In their view the obligation of the *Eli Lilly Co.* to pay for its U.S. purchases in U.S. funds introduced a factor of uncertainty, with the result that the amount set up in the company's books to provide for the premium was a reserve for a contingency (the deduction of which is prohibited by the ITA).

But if the amount which the company set up for the premiums each year is in truth a reserve for a contingency, does it not follow that the appellant company was not entitled to any deduction in respect of that premium in any of the years 1939 to 1945, and the deduction should have been disallowed by the Minister in his assessment for those years? The majority of the Supreme Court does not, however, so hold. Rather they hold that the deductions which the company ought not to have been allowed in the previous years must be

added back to its income in the subsequent year.

Having held the *British Mexican Petroleum* case to be inapplicable for the above reason, the majority then refer with approval to a judgment of Rowlatt J. in which the eminent tax judge held that a deduction claimed by a trader in year 1 in respect of a claim against him which was in dispute must be disallowed if the creditor subsequently abandoned the claim: *Ford v. C.I.R.*, 12 Tax Cas. 997. If this commentator may say so with great respect, that decision is in harmony with the long line of British decisions which establish that in computing business profits an amount is to be entered in the accounts for the year in which the work to which it appertains is done. If that principle is held applicable to the facts of the *Eli Lilly* case, does it not once again follow that when the obligation to pay for U.S. goods supplied in the years 1939 to 1945 is settled for a lesser sum in 1946 it is the accounts for the earlier years which must be reopened?

The minority of the Court were unable to go along with the majority and could find no basis for distinguishing the *British Mexican Petroleum* case. As in that case, they held, the appellant company neither received anything nor was entitled to receive anything in the year 1946.

Unless and until this judgment is overruled by the Supreme Court it may henceforth be taken as the rule in Canada that realized gains or losses to traders in meeting their trade obligations resulting from foreign exchange fluctuations are to be taken into account in computing the trader's business income. The majority decision would also, however, appear to afford the Minister a strong basis for

rejecting a deduction claimed by a trader for premiums on foreign currency until the premium is actually paid since in the opinion of the majority an amount so set up in a trader's books is a reserve for a contingency.

The majority decision is really a rejection of the accrual method of accounting and a reversion to the cash method. One may ask whether it is of any real advantage to the Minister. In the long run traders' gains and losses from foreign exchange fluctuations will balance out, and since gains are held to be equivalent to trade receipts, losses will be deductible as trading losses. There may be those who think that the present decision is regrettable for the complications which it adds to an already sufficiently complicated subject and for its perhaps unconscious attack on established accounting principles for ascertaining periodic business profits.

Oil Wells and Depletion Allowances

In *Home Oil Co. v. MNR*, the Court was concerned with the matter of interpretation. The question in dispute was the amount to which the company was entitled for depletion allowance, which under the law as it stood at the time in dispute was one-third of the taxpayer's profits reasonably attributable to the production from the well after deduction of drilling and exploration costs incurred by the taxpayer during the current and previous taxation years. Thus the greater the amount of the company's profits remaining after the deduction of drilling and exploration costs, the greater the amount of the depletion allowance. The Crown took the stand that in the computation, deduction must be made of all drilling and ex-

ploration costs of the company, that is to say, regardless of whether the expenditures were referable to a producing well or to a dry hole. The company argued that the words "profits of the well" excluded drilling and exploration expenses which were not referable to a producing well, since a dry hole was not a well. In both the ITAB and the Exchequer Court of Canada the Minister was successful. The Supreme Court, however, after a meticulous examination of all relevant provisions of the Act, reversed the decision of the Exchequer Court, and the taxpayer once again proved the validity of the old saw testifying to the virtue of perseverance. The decision is, however, of little lasting interest, since the Crown has long since changed the regulations in anticipation of an adverse (from its point of view) decision in the litigation which has now ended in success for the Home Oil Co.

Income of a Person: What Is It?

In *St. Catherines Flying Training School Ltd. v. MNR*, the appellant school was incorporated with share capital under the Dominion Companies Act, its declared object being to operate a training school for pilots in conjunction with the British Commonwealth Air Training Plan. The company's charter expressly prohibited it from declaring dividends or distributing profits during the war. By a contract between the school and the Dominion Government the school agreed to operate a training school for members of the RCAF for three years at specified fees. The school received donations from local men to enable it to start operations, and the 13 shareholders signed a trust declaration that they held their shares in trust and that on the completion of the contract with

the Crown they would vote to return the donations to the donors and transfer their shares to the school. The flying school operated under the above contract for three years. In March 1943 a new contract for two years was made with the Crown which was in the same terms as the first contract except for a provision that the school's surplus should be retained by the school in a reserve account and on the termination of the contract paid to a flying club approved by the Minister of National Defence, failing which it should revert to the Crown.

The school made a substantial profit under both contracts and was assessed to tax in respect of both amounts. The school contended that none of the profit was liable to taxation on the ground that none of the incorporators intended to derive any gain from the operations of the school but rather to pay it to a certain flying club to assist it in carrying on its work.

The Supreme Court held by a unanimous decision that the profits made by the school while operating under the first contract were income of the school and liable to taxation, but that the profit resulting from its operations under the second contract were not income to the school and not liable to taxation. As to the former, said the Court, the carrying on of training operations was one of the declared ob-

jects of the school, and the provision in the charter prohibiting the declaration of dividends during the war showed that it was contemplated that profits would be realized. While it was true that the charter prohibited the declaration of dividends or the distribution of profits, the prohibition was only for a limited period and the profits retained would increase the value of the shareholders' interest.

But, they proceeded, the surplus arising under the second contract could not, under any circumstances, enure to the benefit of the shareholders, and it was therefore not income of the company. Under the terms of the second contract the surplus was held by the school upon terms that, unless the Minister should consent to its being paid over to a flying club, it was to be paid to the Crown. Thus, in effect, the surplus was held in trust for the Crown.

This decision has a significance which may not be immediately apparent. It establishes that in Canada, under our statute, gains from the conduct of a business are not income of the person operating the business if the gains are impressed with a trust, or something in the nature of a trust, in favour of some other person. In other words, moneys received by a person cannot be income unless, *inter alia*, they are his beneficially. Under the British Act it is otherwise.

Students Department

Associate Professor,
Queen's University

NOTES AND COMMENTS

It is our impression that there have not been many instances in which companies have decided to reduce their share capital in recent years; at any rate, most of the discussion in accounting circles has been about writing assets *up* rather than writing them *down*. An illustration of a proposed reduction in share capital has, however, come to hand. In a letter to shareholders, dated November 16, 1955, the Sherwin-Williams Co. of Canada, Limited has given notice of its intention to submit the required by-law for approval at the annual meeting of the company in December, 1955. The letter reads in part as follows:

"The intangible assets of the company, consisting of formulae, trade marks, and goodwill have been valued at substantially the same figure in its books since the incorporation of the company in 1911.

"Your directors have for a number of years been considering the advisability of reducing this value from time to time in conformity with the usual corporate practice and have now, in consultation with the auditors of the company, come to the conclusion that this amount should be so reduced that, upon consolidation of the accounts of the company with those of its subsidiaries, the item of intangible assets will in the future be carried at \$1.00.

"Such a reduction in the stated value of intangible assets would, for accounting purposes, give rise to a capital deficit unless the paid-up capital of the

company were also reduced. Such being the case, it is intended that the amount of \$5,536,537.67, by which the value of the intangible assets is to be reduced, be charged to the extent of \$4,269,680.00 to the paid-up capital of the company pertaining to the common shares and to the extent of \$1,266,857.67 to the earned surplus account of the company, and thereupon that the paid-up capital pertaining to the common shares of the company be reduced by a like amount of \$4,269,680.00.

"The foregoing proposals do not involve the disposal of any assets and, accordingly, the shareholders' equity will not be affected."

* * *

Once every year in the springtime, when the tulips are in bloom outside our office, and the birds are singing on the window sill, we open our morning mail and find a bill for membership fees from the provincial Institute of Chartered Accountants of which we are a member. We think then of times past, and turn to glance at the certificate which hangs, somewhat unpretentiously, behind our office door. We recall all the times as a student-in-accounts we said how gladly we would pay the annual fee once we had completed the course and passed the examinations! And with the publication of the results of the recent examinations, we would now like to congratulate those of our readers who for the first time will have the privilege of making this payment, along with us, when next the tulips bloom again.

A REVIEW

Students-in-accounts in the senior years of their course will be glad to learn of a new book entitled *Canadian Income Tax Problems* by Marcel Belanger and Donald B. Fields (CCH Canadian Limited). The book comprises some 128 pages of income tax problems, and is divided into separate sections which deal in turn with particular aspects of income tax law, the taxing of individuals, and the tax problems of limited companies.

The book proceeds on the philosophy that "students learn much more easily, and retain their knowledge longer, when they are faced, in their

learning process, with concrete problems to solve". It does not contain solutions for the problems, but at the end of each problem there is a list of appropriate references to the Income Tax Act, to the work, *Introduction to Income Tax Law Canada* by F. E. La Brie, and to CCH Canadian Tax Reporter. We believe that a student who works through a considerable number of these problems, checking the references given with the problems, will be greatly assisted towards an understanding of, and ability to apply, income tax law. The book is available for the modest price of \$2.00.

A REMINDER

As announced in the issue of September, 1955, \$5.00 will be paid to a contributor submitting a puzzle which the editor regards as suitable for the Students Department. An

award of the same amount will be made to students-in-accounts whose letters or contributions are considered of sufficient interest for publication in this department.

SOLUTION TO LAST MONTH'S PUZZLE

Let the speed of plane A be "x" miles per hour.

Then the speed of plane B is "x + 60" miles per hour.

When A is 306 miles from Tripoli, it then takes A 306 hours to reach Tripoli

$$\frac{306}{x}$$

and at the same time, it takes B $\frac{341}{x + 60}$ hours to reach Tripoli.

B reaches Tripoli 6 minutes, or .1 of an hour ahead of A.

Therefore,

$$\frac{306}{x} - \frac{341}{x + 60} = .1$$

Multiply both sides of this equation by $10x(x + 60)$

$$3,060(x + 60) - 3,410x = x(x + 60)$$

$$3,060x + 183,600 - 3,410x = x^2 + 60x$$

$$x^2 + 410x - 183,600 = 0$$

$$(x - 270)(x + 680) = 0$$

Since the speed of the planes is positive, $x = 270$

Then the speed of plane A is 270 miles per hour and the speed of plane B is 330 miles per hour.

CORRESPONDENCE

Vancouver, B.C. November Puzzle when I can solve

Sir: When I was a bureaucrat, I it in three moves instead of four?

was given by a suppliant a small card

o o o o o

on which was printed "Stop and

1. o o o o o

think — There must be a harder

2. o o o o o

way".

3. o o o o o

Do I have to do this with your

R. F. BRUCE TAYLOR, F.C.A.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1954

Accounting II, Question 5 (15 marks)

M and N are partners in a successful business. Profits are shared equally. They have approached R who is willing to invest in the business but feels that, in view of the growth of the business, it should be incorporated. As at 31 Dec 1953 the condensed balance sheet was as follows:

ASSETS

Current

Cash		\$ 12,250	
Accounts receivable	\$ 54,000		
Less estimated bad debts	6,000	48,000	
Inventory at cost		29,000	\$ 89,250

Fixed — at cost

Land		\$ 16,000	
Building	\$ 24,000		
Less depreciation	6,000	18,000	
Equipment	38,000		
Less depreciation	16,000	22,000	56,000
			<u>\$145,250</u>

LIABILITIES

Current

Bank loan	\$ 21,000		
Accounts payable	76,250	\$ 97,250	

Capital

M	16,000		
N	32,000	48,000	
			<u>\$145,250</u>

It has been agreed that a corporation be formed to acquire the assets and assume the liabilities of the partnership as at 31 Dec 1953 upon the following basis:

- (i) The cash on hand will not be taken over nor will the bank loan be assumed by the new company.
- (ii) Bad debts are to be estimated at \$2,000 less than the recorded allowance.
- (iii) The inventory is to be valued at \$33,550.
- (iv) The company will not assume an amount due R, included in accounts payable, of \$5,000.
- (v) Land, buildings and equipment are to be sold to the company at \$19,000, \$25,000 and \$28,000 respectively.
- (vi) Shares, at par, are to be issued to M and N for the net partnership assets taken over on the basis of the foregoing.

In order to bring his capital account to equality with N's, M invested \$16,000 in the partnership on 31 Dec 1953.

The authorized capital of the company is 15,000 shares of a par value of \$10 each.

R will purchase 4,215 shares for \$44,700 in cash.

The new company was formed, the assets taken over and liabilities assumed and the partnership wound up as at 31 Dec 1953.

Required:

Journal entries, complete with narratives, to close the books of the partnership.

A SOLUTION
BOOKS OF M & N

	<i>Dr.</i>	<i>Cr.</i>
Dec. 31 Realization account	84,300	
Accounts payable	71,250	
Accumulated depreciation — Buildings	6,000	
Accumulated depreciation — Equipment	16,000	
Estimated bad debts	4,000	
Accounts receivable		54,000
Inventory		33,550
Land		19,000
Building		31,000
Equipment		44,000
To record sales agreement in books of the partnership		
<hr/>		
Dec. 31 Estimated bad debts	2,000	
Land	3,000	
Buildings	7,000	
Equipment	6,000	
Inventories	4,550	
M Capital		11,275
N Capital		11,275
To transfer profit on sale to M & N capital account		

Dec. 31	Cash	16,000	
	N Capital		16,000
	To record payment of cash by N on 31st December		
Dec. 31	Shares in M N R Co. Ltd.	84,300	
	Realization Account		84,300
	To record receipt of shares in settlement of assets and liabilities		
Dec. 31	Accounts payable	5,000	
	Bank Loan	21,000	
	Cash		26,000
	To record payment of accounts payable to R and payment of bank loan		
Dec. 31	N Capital Account	43,275	
	M Capital Account	43,275	
	Cash		2,250
	Shares in M N R Co. Ltd.		84,300
	To distribute assets to partners on basis of capital account.		

Examiner's Comments

A number of candidates transferred the bank loan and the amount due R to the capital accounts rather than paying them. Some candidates increased the bad debts provision by \$2,000 instead of reducing it. Many candidates had difficulties because they tried to apply a standard answer which they had memorized instead of understanding what was required.

PROBLEM 2

Intermediate Examination, October 1954

Auditing I, Question 2 (10 marks)

In forming an opinion as to the accuracy of the financial statement upon which he is reporting, the auditor looks to his client's bank for certain specific information.

Required:

- (5 marks) (a) What information will the auditor request, under ordinary circumstances, from the client's bank as at fiscal year end date?
- (5 marks) (b) What use does the auditor make of each specific item of information supplied by the client's bank in response to his request?

A SOLUTION

(a) Information which the auditor should request from the bank

1. The balances of the client in all bank accounts, and the name of each account.
2. Details of the client's liability to the bank for loans, and details of the securities held as collateral by the bank against these loans.

3. Details of any contingent liability of the client either as an endorser of notes discounted or as a guarantor.
4. Open letters of credit, and any other direct or contingent liabilities.
5. Securities held for safekeeping for account of the client.
6. Details of notes and accounts held by the bank for collection.
- (b) The use which the auditor should make of the information provided by the bank
 1. To substantiate the bank balances set out in the year end bank reconciliations, and to test interest revenue, if any, on bank balances.
 2. To ascertain that all loans are recorded in the client's accounts at the correct amounts, and to confirm the existence and title of assets held by the bank as security.
 3. and 4. To determine the contingent liabilities which should be disclosed on the balance sheet.
 5. To confirm the existence and title of assets held by the bank in safekeeping.
 6. To test-check the accounts receivable balances, and possibly disclose unusual situations in the collection of certain accounts.

PROBLEM 3

Final Examination, October 1954

Accounting III, Question 3 (20 marks)

The executor of the estate of L has prepared the following information relating to the assets of the estate as at 31 May 1953, the date L died:

(i) Cash in bank, transferred to executor	\$ 10,000
(ii) Cash in house, deposited in trust bank account	\$ 500
(iii) Life insurance, payable to the estate	\$ 50,000
(iv) B. Co. Ltd. bonds, 5% interest payable	
1st Mar and 1st Sept — Par value	\$200,000
Cost of bonds at date of purchase	\$150,000
Market value at date of death	160,000
Market value at date of probate	162,500
(v) Accounts receivable	\$ 800
(vi) Automobile — purchased in 1950 at a cost of	\$ 6,200
Estimated market value at date of death — \$3,000	
Estimated market value at date of probate — \$2,800	
(vii) Residential property purchased in 1948 at a cost of	\$ 50,000
Estimated market value at date of death — \$55,000	
Estimated market value at date of probate — \$56,000	
There was a \$10,000 6% mortgage on the residence;	
interest thereon payable quarterly 31 Mar, 30	
June, 30 Sept and 31 Dec.	
(viii) Rented property purchased in 1948 at a cost of	\$ 12,000
Estimated market value at date of death — \$13,000	
Estimated market value at date of probate — \$12,500	

- (ix) Mortgage held on local real estate \$ 6,000
 Interest at 6% per annum payable quarterly
 31 Jan, 30 Apr, 31 July and 31 Oct. Interest
 due 30 Apr had not been paid as at date of
 death.

The terms of L's will provide for:

- (i) Bequests as follows:
 \$2,000 to Canadian Cancer Society
 \$3,000 to housekeeper.
 (ii) L's son is to get the car.
 (iii) The income from the estate is to go to his wife and on her death,
 the principal is to be divided equally among his grandchildren.

In June 1951 L made his son a gift of \$5,000 Government of Canada bonds. The market value at date of transfer was \$4,775, at date of death \$4,750, and at date of probate \$4,700.

The cash transactions from 15th June 1953 to 31st May 1954 reflected in the executor's records are listed on *the attached working sheets*.

Required:

- (6 marks) (a) A schedule showing your calculation of the aggregate net value" of L's estate for succession duty purposes.
 (14 marks) (b) Set out in detail on the attached working sheets the charge or credit to "income" and to "corpus" in respect of each of the cash transactions listed.

EDITOR'S NOTE: The cash transactions shown on the working sheets provided with the problem were as follows:

1953

15th June	Payment of funeral expenses	\$ 500
28th June	Payment to widow on account	750
30th June	Proceeds of life insurance	50,000
30th June	Payment of interest on mortgage on residential property for three months ended 30 June 1953	150
30th June	Purchased \$60,000 Government of Canada 3% bonds, interest due 1st March and 1st September, at 95 plus accrued interest ..	57,600
15th July	Accounts receivable realized	500
31st July	Rents collected three months to 31 July 1953	300
15th August	Legal fees re probate	1,500
1st Sept.	Government of Canada bond coupons	900
1st Sept.	Received from trustee for bondholders of B Co. Ltd. as settle- ment in full for principal and interest to 1st Sept. 1953	164,000
1st Sept.	Payment of debts existing at 31 May	1,000
1st Sept.	Payment to widow on account	1,250
1st Sept.	Purchased \$150,000 Government of Canada 3% bonds, interest due 1st May and 1st November, at 98 plus accrued interest ..	148,500
15th Sept.	Cost of redecorating one room of residence	250
30th Sept.	Payment of interest on mortgage on residential property	150
30th Sept.	Rents collected	300
1st Nov.	Government of Canada bond coupons	2,250

30th Nov.	Payment to widow on account	1,000
31st Dec.	Rents collected	300
31st Dec.	Principal and interest paid on account of mortgage on residential property	650
1954		
1st March	Government of Canada bond coupons	900
31st March	Rents collected	300
31st March	Payment of interest on mortgage on residential property	143
15th April	Payment on account of succession duties and interest thereon \$800	8,800
1st May	Government of Canada bond coupons	2,250
15th May	Payment to widow on account	1,200
15th May	Payment of bequest to housekeeper	3,000
15th May	Payment of bequest to Canadian Cancer Society	2,000
31st May	Accepted \$100 in full payment of remaining accounts receivable	100
31st May	Mortgage held by L foreclosed	5,200

A SOLUTION

ESTATE OF L

(a)

VALUATION OF ESTATE AS OF 31 MAY 1953

Cash	\$ 10,500
Life insurance	50,000
B bonds at market	160,000
Interest accrued	2,500
Accounts receivable	800
Automobile	3,000
House	\$55,000
Less mortgage	10,000
	45,000
Rented property and rent receivable	13,100
Mortgage	6,000
Interest	120
Bonds	4,750
	\$295,770
Less Funeral expenses	\$ 500
Debts	1,000
Mortgage interest	100
	1,600
Aggregate net value	\$294,170

(b) CASH BOOK FOR THE ESTATE OF L

		CORPUS		INCOME	
Date	Transaction	Debit	Credit	Debit	Credit
1953					
Jun. 15	Payment of funeral expenses . . .	\$ 500			
28	Payment to widow on account . .			\$ 750	
30	Proceeds of life insurance		\$ 50,000		
30	Payment of interest on mortgage on residential property for three months ended 30 Jun. 1953 . . .	100		50	
30	Purchased \$60,000 Government of Canada 3% bonds, interest due 1 Mar. and 1 Sept. at 95 plus accrued interest	57,600			
Jul. 15	Accounts receivable realized . . .		500		
31	Rents collected three months to 31 Jul. 1953		100		200
Aug. 15	Legal fees re probate	1,500			
Sep. 1	Government of Canada bond coupons		600		300
1	Received from trustee for bond- holders of B Co. Ltd. as settle- ment in full for principal and interest to 1 Sep. 1953		161,500		2,500
1	Payment of debts existing 31st May	1,000			
1	Payment to widow on account . .			1,250	
1	Purchased \$150,000 Government of Canada 3% bonds, interest due 1st May and 1st Nov. at 98 plus accrued interest	148,500			
15	Cost of redecorating one room of residence			250	
30	Payment of interest on mortgage on residential property			150	
30	Rents collected				300
Nov. 1	Government of Canada bond coupons		1,500		750
30	Payment to widow on account . .			1,000	
Dec. 31	Rents collected				300
31	Principal and interest paid on ac- count of mortgage on residential property	500		150	
1954					
Mar. 1	Government of Canada bond coupons				900
31	Rents collected				300
31	Payment of interest on mortgage on residential property			143	
Apr. 15	Payment on account of succession duties and interest thereon	8,000		800	

May 1	Government of Canada bond coupons			2,250
15	Payment to widow on account		1,200	
15	Payment of bequest to housekeeper	3,000		
15	Payment of bequest to Canadian Cancer Society	2,000		
31	Accepted \$100 in full payment of remaining accounts receivable ..		100	
31	Mortgage held by L foreclosed		4,911	289
		<u>222,700</u>	<u>219,211</u>	<u>5,743</u>
				<u>8,089</u>

EDITOR'S NOTE: In the editor's opinion a case could be made for treating the \$164,000 received from the trustee for the bondholders of B Co. Ltd. (as settlement in full for principal and interest to 1 Sept. 1953) in the same way as the proceeds of the mortgage foreclosed 31 May 1954. The basis of allocation would then be as follows:

Principal		\$200,000	
Interest to May 31, 1953 (3 months)		2,500	
Interest May 31 - Sept. 1, 1953 (3 months)		2,500	
		<u>\$205,000</u>	
Credit to corpus: $\frac{164,000}{205,000} \times 202,500$			\$162,000
Credit to income: $\frac{164,000}{205,000} \times 2,500$			2,000
			<u>\$164,000</u>

Examiner's Comments

The common errors by candidates were:

1. Basing the answer to part (a) on a provincial succession duty act.
2. Lack of knowledge of "aggregate net value".
3. Failure to realize that the sheets provided were from a cash book.

Current Reading

Assistant Professor,
McGill University

MAGAZINE ARTICLES

AUDITING

"AUDIT PROGRAM PLANNING" by R. K. Mautz, *The Illinois Certified Public Accountant*, March 1955, pp. 2-6

Professor Mautz's approach to the development of an audit program has long been needed. For too many years, students have been presented with a list of audit procedures to be memorized and reproduced verbatim, leaving them with the impression that once these are mastered they may be applied in almost any and every circumstance.

In place of this approach, Professor Mautz stresses the need for a sound understanding of basic audit techniques and their application. He gives the reader, in other words, the "tools of the trade" and then proceeds to show how a pattern of thinking about their application to any audit problem may be developed.

Two general approaches, familiar to all auditors, for the examination of general ledger account balances are discussed. The first, termed the accounting review, implies working back from the general ledger accounts to the underlying documentary evidence. This review should be performed, Professor Mautz continues, to study the validity of the recorded transactions, to search for unrecorded transactions, and to prove the clerical accuracy of the bookkeeping. Independent verification of an account

balance, the second general approach, should be performed to verify an account balance directly, without reference to underlying records. Physical count, written confirmation, and correlation of account balances are illustrative.

The author warns that accounting review and direct verification are not alternative approaches, but are, in fact, complementary methods of attack. In the examination of accounts receivable, for instance, the auditor not only obtains external written confirmation of the accounts but also devotes some time to the build-up of the accounts receivable general ledger balance.

It is within this framework that Professor Mautz illustrates his application of the basic audit techniques:

"Techniques primarily useful for direct verification:

Physical examination and count

Confirmation

Correlation with related information.

"Techniques primarily useful in accounting review:

Examination of original documents and comparison with record

Retracing bookkeeping procedures

Scanning

Examination of subsidiary records

"Techniques of general applicability:

Recomputation

Inquiry"

He emphasizes that the classifica-

tion is not intended to be exclusive. The techniques are classified on the basis of their primary applicability; but any technique in one category may be useful in another.

Here, then, in place of a list of procedures, is a pattern for thinking about the application of the basic "tools" of auditing. How much more desirable this is than the use of innumerable lists of standard procedures as a method of teaching or studying audit program preparation.

"A CASE STUDY ON THE EXTENT OF AUDIT SAMPLES", *The American Institute of Accountants*, pp. 128.

This booklet describes the actual situation of a manufacturer of hardwood flooring and its wholly-owned subsidiary, and presents the views of eight accountants as to the extent of sampling each one thought would be necessary in order to express an unqualified opinion. The study suffers from certain inherent limitations stemming from the difficulty of reproducing actual field conditions in a written description of a business. None of the eight suggested programs is held to be ideal, nor is any considered to present minimum procedures.

Nevertheless, many accountants may find it useful, and certainly challenging, to prepare their own programs consistent with the facts of the case, and to compare their views with the views of those who prepared the published programs.

Copies of this booklet may be obtained from the American Institute of Accountants, 270 Madison Avenue, New York 16, New York. Price \$1.75.

ECONOMICS

"IS PRICE INFLATION INEVITABLE?" by Paul W. McCracken, *The Michigan*

Business Review, September 1955, pp. 9-13

After 15 years of almost uninterrupted price inflation, many of us have come to accept "just a little bit more inflation" as a characteristic of modern economic life. Sounding an optimistic note, Professor McCracken, Professor of Business Conditions at the University of Michigan, expresses his belief that the case is not yet established for the view that we shall or should have a slowly rising price level.

He asserts, for instance, that a policy objective of a slowly rising price level is not an alternative actually available in the real world. If price inflation were to become a stated objective of government policy, Professor McCracken thinks that widespread demands for price level escalators to wage rates, salaries, depreciation allowances, and retirement incomes, to cover anticipated rises in the price level, would eventually lead not to slowly rising prices but to rapidly rising prices.

Some maintain that a slowly rising price level would help to stimulate demand by encouraging prompt expenditure. Yet, even here, surveys carried out from 1950-1951 indicated a negative correlation between expectation of price inflation and an attitude that it was a good time to buy.

In Professor McCracken's view, the American economy (and, presumably, because of the close relationship, the Canadian economy) is remarkably resistant to inflation. He cites, for instance, the relative stability of the price level since 1951, and feels that even the severe rise in prices following the Korean war was remarkably mild in view of the magnitude of the shock to which the economy was then

subjected. Few perhaps realize that in 78 post-war months, the United States has experienced 52 months of stable prices and 26 months of rising prices.

No one can deny that in the post-war period the ability of strong labour unions to exact wage increases in excess of the 2% - 3% per year improvement in productivity has led to a rising level of costs, and, in consequence, to increased prices. Professor McCracken doubts, however, that unions will continue to be able to obtain such large wage demands in a less inflationary environment; for employers will not be in a position to pass higher costs on to their customers. He points to the 2% - 3% increase in average hourly earnings in 1954 over 1953 as an indication of moderation in recent wage demands by organized labour.

"Would unions exact wage increases in excess of improvements in productivity, even if it were known that the price line would be held? If so, we would then have to choose between inflation and unemployment . . ." This appears, to Professor McCracken, to be the nub of the labour problem. We may draw some consolation from the fact that this question has not yet been answered conclusively in the affirmative.

FINANCE

"MERGERS NEARING PEAK OF POSTWAR PERIOD", *The Controller*, September 1955, p. 46

An analysis of the Federal Trade Commission study of recent consolidations in the United States reveals that mergers are nearing the 1946-1947 postwar peak and are being made at three times the 1949 rate. While the vending company is said to be the

initiator in some cases, the first offer is generally made by the acquiring concern.

It is reported that 40% of the mergers are made to gain additional capacity while at the same time acquiring a market previously served by a competitor. The desire to diversify products is the motive behind another 25% of the mergers. The majority of the remainder are effected to gain sources of supply, make ultimate sales to consumers, or gain additional capacity in new markets. Other reasons are stated to be the inability of smaller companies to finance adequate expansion and modernization, surplus cash in hands of purchasers, aging owners who want to retire, or tax savings.

A second study by the Commission indicates that mergers are often originated by outside financial interests or other interests who find that as a result of stock ownership, interest in product or services to be provided, or fees to be collected for promotion assistance, the merger is to their own advantage.

"CASH CONTROL SYSTEM IN COMMUNISTIC CHINA" by S. T. Smith, *The Accounting Review*, October 1955, pp. 602-604

Mr. Smith outlines the operation of the stringent cash control system that was first introduced in Manchuria on January 10, 1950.

The Chinese central authority has laid down a limit for cash on hand. All cash in excess of this limit must be deposited in the People's Bank of China, which is the appointed central bank. Each individual business unit must submit a cash budget to the central bank. These unit budgets are consolidated into area cash budgets,

which in turn form the basis for the national cash budget.

A sharp distinction is made between short and long-term business investment, reports Mr. Smith. The former is governed and financed by the central bank, while the industrial bank finances and governs long-term credit.

To effect a control over transfers of funds between business units, all business units and government departments must open individual accounts in the central bank. Inter-firm cash settlements and credit grants are prohibited, and all settlements must be effected through the central bank.

The Chinese government has apparently been successful in stabilizing commodity prices by this system, but the price in terms of accounting duties has been heavy. Mr. Smith states that there are now 400,000 employees of the People's Bank compared with the 35,000 staff members of the four national banks that were in operation during the Nationalist regime. It is not unusual, he says, for working days of 12 hours or more to be necessary in order to perform the heavy accounting duties involved.

MANAGEMENT

"10 PROBLEMS THAT WORRY PRESIDENTS", by Lyle M. Spencer, *The Harvard Business Review*, November-December 1955, pp. 75-83

Mr. Spencer's article is based on a file of information collected over a period of three years about members of the Young Presidents' Organization, a club possessing 950 members, all of whom became presidents of their companies before reaching the age of 40. They are therefore pre-

sumed to be more able than the average company head in the United States.

The typical member of the group is said to be now 39 years old, and has been head of his company for four or five years. According to Mr. Spencer's analysis he is a college graduate who majored in business administration and was in the top third of his class academically. Engineers are stated to possess a reasonable chance of becoming a company president. Remarkably enough, however, there are, in the group surveyed, few young presidents with only a liberal arts background.

An appraisal of their ten major problems leads Mr. Spencer to conclude that many of the problems which produce recurring, day-to-day anxiety among most presidents are related in one way or another to lack of time. His analysis of the work habits of more than 400 members of the group shows that most of them devote far too much time to problems and activities which they could delegate to others. They tend to spend too much time on activities they enjoy, which in turn tend to be the things they can do best. In Mr. Spencer's opinion, most company presidents could leave themselves from one to three hours a day for other activities if they planned more carefully and budgeted their time.

Personal procrastination, he continues, is a major problem with many presidents, and is, in itself, a factor bearing on many of their other problems. He finds, for example, that it is an important factor in delaying solutions to problems in which the president is emotionally involved. While the final decision may not take long, the facing up to a task which

may be personally distasteful may cause considerable delay.

It is readily apparent that these two important areas of difficulty are human factors, self-created by the men concerned. Recognizing this, the Young Presidents' Organization is experimenting with "executhery" in an attempt to alleviate the burden under which the modern chief executive now labours.

TAXATION

The Journal of Accountancy, October 1955, pp. 29-30

In its editorial, *The Journal of Accountancy* commends the Secretary of the United States Treasury for what it calls "a remarkable display of political valour". Mr. Humphrey's remarks were sufficiently general that their validity need not be restricted solely to the United States:

"The power to tax," he said, "is the power to destroy, and revenue laws should be used only to equitably raise revenue, not for other indirect purposes. It is dangerous to use the tax laws for social purposes, to favour one citizen or group of citizens over others, to exercise economic controls, or to indirectly subsidize any segment of our economy. . . ."

Commenting editorially, the *Journal* says:

"Accountants, who struggle daily with the problems of determining taxable income, should be among the first to recognize the merits of Mr. Humphrey's philosophy of taxation. The attempt to advance social aims through taxes greatly complicates the task of correctly computing the taxpayer's obligation to the government . . ."

The editorial then discusses some other consequences of injecting social objectives into tax statutes:

"It influences the manner of conducting a business and, in extreme cases, results in more of a tax on behaviour than on income. The effort to escape or reduce this burden may also encourage a business to manage its own affairs in a way that could injure its long-range economic health. Moreover . . . the introduction of social objectives into tax legislation obscures the cost of achieving these objectives. It does even more than that: it often obscures the objectives themselves and thus adds to the difficulty of obtaining a sound measurement of our advances. . . ."

However, the *Journal* does not see much hope of purifying the tax code in the immediate future. In fact, it concludes that any sudden change would create widespread confusion and considerable hardship (and presumably would engage accountants in an even greater struggle than the determination of taxable income presently entails).

BOOK REVIEW

The Canada Year Book 1955. Dominion Bureau of Statistics; pp 1374; price \$3.00

The 50th anniversary number of *The Canada Year Book* has just been released by the Dominion Bureau of Statistics and is available from the Queen's Printer. Apart from the official tabulation of the resources, institutions and social and economic conditions of Canada, this edition contains several feature articles of current interest. These include: "The Northland - Canada's Challenge", "The St. Lawrence Seaway", "Post-War Immigration", and "The History of the Canadian National Railways". A large folding map of Canada is enclosed in the pocket on the inside back cover of the book.

NEWS OF OUR MEMBERS

British Columbia

Wm. K. Trusler, C.A. and R. P. Dewar, B.Com., C.A. announce the acquisition of the practice at Duncan, B.C. formerly carried on by Mr. Trusler as resident partner of McDougall, Trusler & Lavery, Chartered Accountants. Henceforth practice of the profession will be carried on under the firm name of Trusler, Dewar & Co., Chartered Accountants, with offices in the Whittome Bldg., Box 413, Duncan.

The Nanaimo, B.C. practice of McDougall, Trusler & Lavery, Chartered Accountants, will henceforth be carried on by R. McDougall, C.A. and T. M. Lavery, C.A. under the firm name of McDougall & Lavery, Chartered Accountants, with offices at 141 Bastion St., Nanaimo.

Manitoba

Eric Wright, C.A. spoke on the application of electronics to accounting at a meeting of the Winnipeg chapter of the Institute of Internal Auditors on November 17 last.

Herbert L. Burch, C.A., Alan E. Findlay, C.A. and John G. McFarlane, C.A. announce that their partnership formerly known as H. L. Burch & Co. will be continued under the firm name of Burch, Findlay, McFarlane & Co., Chartered Accountants, with offices at 816 Toronto General Trusts Bldg., Winnipeg, and at Minnedosa.

Nova Scotia

H. R. Doane & Co., Chartered Accountants, Halifax, announce the admission to partnership of Albert L. Barkhouse, Moncton; Stanley N. Inkpen, St. John's; William B. Draper, Liverpool; Calvin A. Rice, Dartmouth; F. Joseph Hill and Carl K. Miller, Halifax.

Ontario

Albert Pearl, C.A. announces the re-

moval of his office to Regency Towers Hotel, 89 Avenue Rd., Toronto.

Irving Reiss, C.A. announces the removal of his office to 2 McCaul St., Toronto.

Stern, Sanders & Co., Chartered Accountants, 667 Yonge St., Toronto, announce the opening of a branch office at 152 Main St. E., North Bay.

Rogers & Roberts, Chartered Accountants, announce the removal of their offices to Rm. 501, 30 Bloor St. W., Toronto.

R. L. B. Joynt, C.A. is now treasurer of Canadian Kodak Co. Ltd., Toronto.

John A. McCleery, C.A. has been appointed treasurer of the Sherriff-Horsey Corp. Ltd., Don Mills, Toronto.

Webb & Francis, Chartered Accountants, announce the removal of their offices to The Castle Bldg., 1 Duke St., Hamilton.

Field, Darch & Company, Chartered Accountants, announce the opening of their office at Ste. 24, 2 Bloor St. E., Toronto.

Quebec

Richter, Usher & Vineberg, Chartered Accountants, 660 St. Catherine St. W., Montreal, announce the admission to partnership of Ernest Duby, C.A.

Marcel Rivard, C.A. and Henry Hudon, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Rivard, Hudon & Co., Chartered Accountants, with offices at Ste. 512, 10 St. James St. W., Montreal, and 388 Main St., Farnham, Que.

James T. Black, C.A. has been appointed comptroller of Molson's Brewery Ltd., Montreal.

James S. Smart, C.A. has been appointed assistant treasurer of Canadian Chemical and Cellulose Co. Ltd., Montreal.

Rolls-Royce of Canada Ltd., Dorval Station, Que. announces the appointment of G. D. Rediker, C.A. as chief accountant.

INSTITUTE NOTES

C.A.'s Discuss G.A.W.

The second dinner meeting of the current season of the Hamilton and District Chartered Accountants Association was held on November 29, at the Royal Connaught Hotel. Mr. Stuart D. Armour, economic adviser to the president of Steel Company of Canada, was guest speaker and addressed the meeting on "Economic Consequences of the Guaranteed Annual Wage".

ONTARIO INSTITUTE NOTES

Group Life Insurance: The proposal to increase the compulsory group life insurance from \$5,000 to \$7,500 for all partners and principals of participating firms who have been in the plan for at least five years was made to the firms in August. As only one firm opposed the increase and only three firms failed to give an opinion, the Council has approved the increase with effect from the next renewal date of April 1, 1956.

Letters requesting renewal information for the group plan will be mailed in February. The Canada Life Assurance Company usually sends letters inviting all firms who have not joined the plan to do so, but any firms who are interested may so advise the registrar now. Although the company can demand medical evidence of insurability from new firms entering the plan they have not yet done so. The only other stipulation is that there must be a staff of at least three.

Presentation of Certificates: Mr. J. G. Glasco, O.B.E., F.C.A., immediate past president of the C.I.C.A. and a past president of the Ontario Institute, will deliver the address of welcome to the new members at the convocation to be held at 3:00 p.m. on Friday, February 10, 1956 at the Royal York Hotel.

Practising Members' Discussion Groups of

Toronto: The five groups got under way in late November and held their second meeting in December. Attendance varied from 1/3 to 1/2 of the group membership. New members by examination and others who previously did not join a group are invited to do so. Simply write a note to the registrar specifying the group you wish to join. Groups are as follows: A (Mondays) Office Routine and Management; Building clientele; B (Tuesdays & Thursdays) Estate Planning; Taxation; C (Wednesdays) Audit Procedure and Standards Financial Statement Presentation; D (Mondays) Machine Accounting; Management Accounting; E (Tuesdays & Thursdays) Taxation; Company Law; Prospectuses & Securities Commission Requirements.

Workmen's Compensation Board Filing

Date: The due date for filing the next payroll statement is February 29, 1956 instead of January 20 as in the past. From January 1, 1956 all current year assessments will be due in one payment.

C. A. Patterson Prize: One hundred and fifty-five of the friends and associates of the late C. A. Patterson, F.C.A. have contributed \$2,490.36 to establish an examination prize in his memory. "Pat" was a past president of the Ontario Institute who died suddenly in 1953. The Council has accepted the generous offer and established the "C. A. Patterson Prize of \$100 to the winner of the Ontario Institute Gold Medal". At the same time the Council increased the intermediate first prize from \$50 to \$100.

List of Ontario Members: Arrangements have been made again to print and distribute a complete list of members of the Institute. This listing as of June 30, 1955

will be sent out at the same time as the C.I.C.A. Members Directory is published which should be just before this number of the magazine.

Taxation Committee: Under the chairmanship of J. S. Innes, the committee held 10 meetings last fall and prepared a six page report for consideration of the C.I.C.A. Taxation Committee. A consolidation of the reports of all the Institutes, approved by the Joint Committee of the C.I.C.A. and Canadian Bar Association, will be presented to the Federal Government early in 1956.

By-law 2A: Two applicants under by-law 2A have been admitted to membership in the Institute by Council on the recommendation of the committee of the president and four past presidents. These are the first admissions since the by-law was passed in June 1953. The one is A. B. McConnell of London, Ontario, who is a B.Sc. (Accounting) from the University of California and a member of the California State Society of C.P.A.'s. The other is P. W. Trahair of Toronto who became a C.A. in South Africa in the Transvaal Society of Accountants.

Affiliation: The following applicants were admitted to membership by affiliation on November 18: Ignatius Neal Curry (Ire. '49), James Albert Redman (Eng. '53), Gordon Randle Devey (Eng. '52), John Michael Chesney Rowland (Eng. '49), Eric Greenwood (Inc. '52), Charles Taylor Stoess (B.C. '49), Oliver William Hobson (Eng. '53), Oliver Clifford Tidbury (Eng. '40), Jack Mailer Lilley (Scot. '53), W. Albert Robertson (N.B. '53, P.E.I. '53), Michael Maurice Monk (Eng. '54), Michael S. Wallace (Que. '55), Dallas Harper Nairne (Scot. '50).

Resignation: T. P. Hill has resigned his membership.

Annual Conference 1956 Kingston: W. G. Leonard, F.C.A. and W. L. McDonald, F.C.A. are the chairmen of the committees on arrangements and program for the annual conference to be held at Queen's University in Kingston on Monday, June 18 and Tuesday, June 19, this year. Tentative plans include technical sessions, informal luncheons, the Institute annual meet-

ing on Monday afternoon and a dinner with a speaker Monday evening. As the emphasis at the conference will be on the technical sessions, the families of members are not being invited to attend and there will be few social functions.

Registrations: In the year ending October 20, 1955 316 students-in-accounts registered as compared with 387 in the year before. The numbers by categories were as follows showing the comparative figures for the previous year in brackets: Grade XIII or equivalent 224(282); university graduate 44(51); B.Com. or equivalent 41(49); students from other Institutes 7(5). The decline in the total number unfortunately does not reflect a decrease in the need for staff but, instead, a lack of applicants. The members are making tremendous efforts to attract students and with considerable success. However, it must be remembered that the graduates of high schools and colleges this year were largely born in the 30's when the birth rate was relatively low. The number graduating is therefore much too small to fill the demands of Canada in 1955. The ability to register three or four times the number of students who enrolled in the 1930's gives a good indication of the strength of the profession. It also means that applications will be far short of the demand until 1960, when the increased number of babies born during the 1940's begin to graduate from school.

Grade XIII Requirements: The Department of Education of Ontario has introduced a new Grade XIII course in Geography commencing in September, 1955. The course is designed to develop the students' powers of observation and reasoning by a study of Canadian geography. Subject to confirmation of the next annual meeting the Council, pursuant to by-law 31, has included Grade XIII Geography as an optional paper for registration as a student-in-accounts.

Members' Supper Dance and Cabaret 1956: Thursday, November 15, 1956 is the date reserved for the next dance. The place is the banquet hall, Royal York, Toronto.

ONTARIO STUDENTS NOTES

The 1955 Fall Dance was held at the Club Kingsway on Thursday, December 1. There were 458 present, the band was good and the entertainment excellent. This sort of attendance will make it difficult to keep establishing records year after year, but it is certain that next year's Council will do its best to beat it.

January Meeting — The first get-together of the year will be held on Tuesday, January 10. Dr. Ward Smith, medico-legal

expert with the Ontario Provincial Government, will be our guest speaker and the meeting will be held in the lecture hall of the Chartered Accountants Building at 8 o'clock. At the time of going to press, it has not been established whether Dr. Ward Smith will be dissecting any corpses for the edification of the student body, but it can be taken for granted that what he will have to say will be interesting and dynamically presented. Questions and refreshments, both of the usual high order, after the meeting.

The editor welcomes information for this column. News of members and provincial Institutes' activities should be received by the 14th of the month to appear in the following issue of the journal.

OBITUARIES

Ernest E. Widdowson

The Institute of Chartered Accountants of Saskatchewan announces with regret the death of Ernest Edward Widdowson in his 57th year.

A native of Wolverhampton, England, Mr. Widdowson came to Canada in 1926 and entered the firm of T. E. Robinson in Regina, later becoming a partner in the firm.

At the time of his death Mr. Widdowson was comptroller at Smeed's Security Storage in Regina, to which position he was appointed in 1952.

During the First World War he served in the Imperial Army in France being wounded in 1917 in trench war-fare.

Mr. Widdowson was one of the organizers in Regina of the Army and Navy Veterans Association, and was past president of the Disabled Veterans Association. For many years he was a member of the Royal

Antediluvian Order of Buffalos and of the Moose Lodge.

To his wife and family the members of the Institute extend their deepest sympathy.

W. E. Dunton

The Institute of Chartered Accountants of Quebec announces with deep regret the death of W. E. Dunton on October 27, 1955.

Mr. Dunton was born in Montreal and educated at Lower Canada College, Montreal High School and McGill University. He enlisted in the Princess Patricia's Canadian Light Infantry in 1914 and served overseas with them. In 1919 he joined the firm of McDonald, Currie & Co., and later joined a brokerage firm. He was admitted to membership in this Institute in 1923.

Mr. Dunton was appointed chairman of the Montreal Protestant Central Board which later became the Greater Montreal Board in 1946. His service with the board

began in 1925 when he was appointed comptroller and secretary-treasurer. He held this position until 1929 when he retired to enter private practice, later returning as a serving member in 1943.

From 1934 to 1953, Mr. Dunton was consulting auditor for the Montreal Stock Exchange and the Canadian Stock Exchange.

At the time of his death Mr. Dunton was a member of the Protestant Committee

on Education, and a member of the Corporation and Board of Governors of Lower Canada College. He was past president of the Royal Montreal Curling Club, a past president of the Murray Bay Golf Club, a trustee of the Murray Bay Protestant Church, and vice-president of the Murray Bay Convalescent Home. He was a director of several companies.

To Mr. Dunton's family, the Council and members of the Institute express their sincere sympathy.

(Continued from page 31)

And yet, I cannot, on an occasion such as this one, confine myself merely to congratulating you on the admirable services which you have rendered in the past, and on the fact that there seems likely to be a steady and increasing demand for similar services in the future. Such reflections are gratifying, but they are not enough. The man who does his own work well, without any attempt to see it in a wider context, is a good workman and no more. The professional man who narrows his vision thus, is hardly even a good professional man. Your interest extends far beyond the actual service you render.

Observers say that Canada shows political maturity, a maturity in keeping with the national character, free from haste or exuberance, slow and cautious. Canadian contributions at meetings of international bodies are said by others to be marked always by moderation and impartiality.

Most significant for the future, is our growth in matters of the mind and of the spirit. In my journeys, I have found a vivid interest among Canadians about new resources to be developed and new areas to be discovered quite unconnected with material progress. For instance, it is now, I believe, true that the nation is prepared to regard painting and music and letters as national activities, along with forestry, manufacturing, wheat-growing and mining; universities as well as railways are looked on as institutions of national importance; the author of a distinguished book is worthy of national recognition. All this has given immense encouragement to Canadians working in those fields.

In Canada today the important thing is that so many young people trained in literature or other things — painting, music, sculpture, drama — feel that they have things they must say; and that people will listen. This is their concern: not to produce a Canadian masterpiece, but to speak, to be heard and to be understood. Some day, I believe, we will make an important and genuine contribution to the wealth of the great civilization which has nourished us.

All these things are a part of our life, a part of the national life to which you, as accountants, contribute your business skill. It is my privilege and my pleasure on this happy occasion, to congratulate you once more on your past achievements, and to wish to you success and well-being in the years to come.

At the conclusion of the speeches, the company sang "O Canada" and made their way into the Champlain Room for dancing.

SWEETNESS AND LIGHT

Fortifying the Inner Man

For the last two days a car with a loudspeaker has been driving around the Yonge-Bloor intersection in Toronto broadcasting to all and sundry that a new restaurant has been opened nearby and that all lunch eaters looking for the "Businessmen's Special" will find there the object of tongue's desire. This brings to 14 the number of restaurants clustered around that particular corner.

All this catering to noon-day eating pleasure is of fairly recent origin. Forty years ago, unless a man went home at noon, lunch was just a functional activity to be performed with a minimum of fuss and bother. Almost 80% of the people brought a lunch to work in a brown paper bag and at twelve or one o'clock slipped into an out of the way corner and ate it, and then perhaps went out for a quick cup of coffee. With the prosperity of the 1920's, however, it began to be a mark of distinction, on the way to work, to be seen *not* carrying a brown paper bag. Then it was that many a man who wanted to be numbered with bagless ones but felt his finances obliged him to remain with the be-bagged group resorted to the device known as the Great Briefcase Swindle. He would invest in a briefcase, preferably of large size and with stiff sides, and each morning put in it a secret package of undisclosed contents and then carry the briefcase to work. To anyone but his wife, and possibly an-

other briefcase carrier, he could well pass for a barrister learned in the law who was hastening to plead a case before the Supreme Court.

But truth will out and when the sales of briefcases soared suspiciously the jig was soon up. It was not long before the great ambition of the white collar worker was to eat out at noon. As soon as he could afford it, he became a frequenter first of the Greasy Spoon where he sat on a stool and grabbed a sandwich, then of the Empire Grill where he sat in a booth and ordered the No. 4 Luncheon Plate, and eventually of *The Mayfair* where today he is greeted at the door by a hostess and led to a choice table with all due decorum and respect.

Yet like Ulysses, the modern businessman has found that his horizon always keeps ahead of him. Now his great aim is to dine (he no longer eats) at his Club where in company with a select coterie he can sit at "his" table and devour far more than is good for him, taking of course far more than 60 minutes to do it. At the present time only a few have arrived at the Club stage but no doubt it will be the coming thing of the next ten years.

Where will man go after he rises above lunching at the Club? It is anyone's wild guess, but it could be that the executive office of 1975 A.D. will be equipped with an electronic range which a secretary can set at 11.58 a.m. for a full course meal. At 12 noon her boss can retire into an out of the way alcove, made into a sitting-room, and eat, and so end his lunching days in somewhat the same posture as he began them many years before. At least that is what is in store for the gentleman if Betty Furness has her way! JEAN VALE

CLASSIFIED ADVERTISEMENTS

Rates: Positions wanted, \$7.00 per column inch; Positions offered, \$10.00 per column inch; Open rate \$17.00 per column inch.

All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.

Closing date is 14th of preceding month

REQUIRED: Large and expanding Canadian industry requires young industrial accountant with university or accounting degree. Must be thoroughly experienced in all phases of industrial accounting, excellent opportunity for a capable, ambitious person to advance to responsible position. Box 533.

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ACCOUNTANTS FOR VENEZUELA:

Young industrial accountants with the degree of C.A. are required for staff positions as methods analysts in the two principal cities of Venezuela. An ideal climate, comparable living conditions in addition to attractive earning possibilities make these positions especially appealing. The planned functions of these positions afford a unique training opportunity in broadened experience which will substantially improve prospects for major administrative appointments either in Venezuela or on return to Canada. Contracts are for two or three years, renewable by mutual agreement. Please send complete summary of qualifications and experience. Box 538.

PRACTICE FOR SALE: Small practice in the city of Hamilton. Would consider partnership with another small accounting firm or outright sale. Box 537.

CHARTERED ACCOUNTANT: Wanted, chartered accountant or accounting student who has written final examinations for office in Hamilton, Ontario by firm of chartered accountants. Good salary, diversified experience and pleasant working conditions offered. Box 535.

ACCOUNTANT — OFFICE MANAGER:

A progressive wholesale organization requires a qualified accountant capable of supervising its accounting department and of managing its head office.

Candidates should be in the age range of 28-35 and have a recognized degree in accounting or equivalent. Experience in costing and budgetary controls an advantage.

This is a position offering good possibilities of advancement through demonstrated ability. Starting salary commensurate with qualifications plus usual benefits including pension and profit sharing.

Applications will be regarded as confidential and should include full details as to education, experience, etc. Box 536.

MALE HELP WANTED: Senior and intermediate clerks required for a chartered accountant's office in Northern Ontario. Apply in writing stating details of experience and qualifications.

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Transportation arranged if interview required.

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